CHAPTER 34

Marketing and competitiveness

This chapter introduces the concept of market conditions, examining the features and level of competition in different markets. These market conditions are also examined through Porter's five forces model. The link between market conditions and the marketing mix is scrutinised. The determinants of competition and methods of improving a business's competitiveness are then examined.

The business environment

Businesses operate in a competitive environment. The nature of this competition varies from industry to industry, but almost all firms face some level of competition. The number of competitors, for example, dictates the extent to which a business can raise or lower its prices, and the amount of advertising it is likely to undertake.

Markets and market structure

KEY TERM

market: a place where buyers and sellers come together.

Some markets are highly competitive with many small businesses operating in them, each selling only a small proportion of total market sales. Other markets tend to be dominated by a few large firms, each selling a significant proportion of the total market sales. The size of a market is measured either by volume (the number of units sold) or by value (the money spent on all the goods sold).

In practice, defining the nature of a market is quite complex. For example, is British Gas in the gas provision market or in the fuel provision market? This will determine whether it sees itself as competing only against other gas suppliers or against all fuel suppliers, including those supplying coal, electricity and oil. Similarly, do newspapers compete only with other newspapers or with all other news sources, including the internet, radio, and cable and satellite television? The managing director of Waterman Pens is famously quoted as saying, 'We are not in the market for pens, but executive gifts.' Thus he redefined the company's competitors as Dunhill and Rolex, rather than, or in addition to, Parker and Bic.

Market structure and the degree of competition

In general, four different market structures explain the broad range of competitive environments in which most firms operate. These range from monopoly

situations where, in theory, there are no competitors, to perfect competition where there are many competitors.

KEY TERM

monopoly: in theory, a single producer in a market, but in practice a firm with a market share of 25% or more.

Monopoly

The potential danger of monopolies is that they exploit the consumer. If there is little or no competition in providing a particular product or service, and therefore few or no alternative supplies of it, monopolists could charge high prices and offer poor service, and they might simply waste scarce resources by being inefficient.

Where monopolies exhibit or are likely to exhibit any of these characteristics, the government investigates them and can require them to change their behaviour and subject them to large fines. When the former nationalised utilities, including gas, electricity and water, were privatised, regulators such as Ofwat and Ofgas were appointed to control them, in order to ensure that they did not abuse their monopoly position.

Before the 1980s, the UK had a number of true monopolies in the form of the nationalised industries, including British Coal, British Gas, British Steel, British Rail and other utilities such as electricity and water. All these industries were privatised and opened up to competition, so that in the UK today true monopoly situations are rare.

However, businesses with more than 25% of the market continue to exist because it is extremely difficult for a new firm to enter the market of a monopolist owing to high barriers to entry. These barriers to entry include:

- the high capital costs required to set up a new business in markets in which existing firms are monopolies
- patents that allow existing firms to 'monopolise' the market legally
- the loyalty of customers to existing firms
- the need to achieve large cost savings quickly in order to be able to charge a competitive price

FACT FILE

Airport competition

Pressure is being put on the government to introduce more competition in airports. Currently, BAA has a monopoly in the London area, as it owns Heathrow, Gatwick and Stansted airports. Critics believe that facilities at these airports compare unfavourably with those at other international airports because there is little incentive for BAA to spend money on improving facilities when it is almost guaranteed that customers in the London area will use one of its airports. BAA also owns a number of regional airports.

KEY TERM

oligopoly: a market dominated by a small number of large businesses, known as oligopolists.

Oligopoly

Oligopoly markets may seem to be extremely competitive because each producer competes fiercely in order to maintain or increase its share of the particular market. However, if one oligopolist reduces its prices, the others

DID YOU KNOW?

Monopsony means a single buyer, as opposed to a monopoly, which is a single seller. A single buyer of a product has a great deal of power over the supplier of the product. For example, it can force the supplier to lower prices, it can delay payment or it can impose stringent quality standards, and the supplier can do little in response since there are no alternative buyers with which to trade. This situation often emerges in practice when a small firm, such as a pig farm making its own sausages, sells all of its products to a large firm, such as one of the major supermarket chains. In 2007 the Competition Commission investigated whether supermarkets were taking advantage of their position as 'monopsonists' by forcing down the prices that they offer their small suppliers. It found that this was the case with some of the supermarkets' practices.

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follow suit and so no firm gains. Similarly, a business that increases prices may lose market share, as the other oligopolists may not copy this strategy. Therefore, rivalry usually takes the form of **'non-price' competition**, such as special offers and advertising.

Cartels are illegal in the UK, but they are often difficult to detect. If they are found out, legal action can be taken to force the firms involved to change their behaviour and a fine of 10% of revenue can be imposed. In September 2007, the government conducted an investigation into milk prices set by the main supermarkets and discovered that they were colluding in fixing the prices for consumers. At the time of writing (January 2008), the investigation has not been fully concluded but some supermarkets and suppliers have been fined £116 million. The Competition Commission estimates that, over a 3-year period, consumers paid over £270 million more than was necessary for their milk.

KEY TERM

cartel: a group of firms that come together to agree price and output levels in an industry.

Predicting the behaviour of oligopolies is complex because each firm is aware that whatever action it takes will result in a reaction from its competitors. It must therefore guess this possible reaction and take it into account before undertaking any action itself.

DID YOU KNOW?

Many oligopolies are in fact monopolies under the government's 25% market share definition.

As markets mature and successful firms take over or merge with less successful firms, more markets inevitably become oligopolies. Then, as with monopolies, oligopolies continue to exist because of high barriers to entry.

Monopolistic competition

Monopolistic competition can result from the development of brand names or local reputation. For example, a hair salon might have an excellent reputation and a loyal clientele, which enable it to charge higher prices than other hair salons in the vicinity. A local café or bar might have developed a reputation as the 'place to be' for 18–25-year-olds, even though its prices are much higher than the pub next door.

KEY TERM

monopolistic competition: where a large number of firms are competing in a market, each having enough product differentiation to achieve a degree of monopoly power and therefore some control over the price they charge.

It is easy for a new firm to enter this type of market because the set-up costs tend to be relatively low and the nature of the market is such that there is a constant flow of businesses.

KEY TERM

perfect competition: where there is a large number of sellers and buyers, all of which are too small to influence the price of the product.

Perfect competition

Under perfect competition, all the sellers produce homogeneous (identical) products and are 'price takers', meaning that they accept the ruling market price. The buyers all have perfect knowledge: for example, they know the price being charged in the market. There is perfect freedom of entry into and exit from the market for businesses.

Like the theoretical monopoly of a single firm, perfect competition is rarely evident in practice and tends to be simply a model against which the behaviour of firms in the real world can be compared.

EXAMINER'S VOICE

When you answer case-study questions about particular market situations, try to decide what type of market structure is evident (e.g. whether oligopolistic or monopolistic competition). Then apply your knowledge of the characteristics of the relevant market structure in answering the question (e.g. how a particular market structure will affect the profitability and likely success of the firm, and how it might affect the firm's objectives and strategy).

Table 34.1 summarises the different types of market conditions in which businesses operate.

Table 34.1 *Market conditions*

Characteristic	Perfect competition	Monopolistic competition	Oligopoly	Monopoly
Number and size of firms	Many and small	Many and small	Few and large	One, in theory*
Nature of product	Identical	Differentiated	Differentiated	Unique
Examples	Foreign exchange market, stock market, fruit and vegetable market	Hairdressers, plumbers, cafés and insurance companies	Supermarkets, banks and motor vehicle manufacturers	Nationalised industries (pre-1980s), Royal Mail (for letters)
Barriers to entry	None; it is easy to enter or leave the market	None; it is easy to enter or leave the market	High barriers to entry	High barriers to entry
Effect on business	Price takers Cost efficiency needed for survival No real scope for marketing Very low profit margins	Some control over price Cost efficiency is important unless the firm has a strong USP Benefits from marketing Low profit margins	Non-price competition High overheads High profit margins but aim to achieve USP through branding High spending on promotion Collusion can occur between firms	Price setter Can become complacent Power depends on importance of the product and its alternatives High profit margins

*In theory, a monopoly is a single producer; in practice, a monopoly is a firm with a market share of 25% or more.

Porter's five competitive forces

An alternative or additional way of analysing market conditions is to draw on Michael Porter's idea of **competitive forces**. Some firms struggle to survive