

**A SELECT REVIEW OF THE LITERATURE ON  
BARRIERS TO NEW COMPETITION**

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## INTRODUCTION

"The ownership of exclusive facilities for production or trade in the modern world does not always suggest to a man of sound judgement that he should pursue a severely monopolistic price policy. On the contrary he will keep a watchful eye on the sources of possible competition; direct or indirect. If it appears that these sources are likely to prove large and strong, and the pace at which competitive supply runs is likely to become considerable before long then he will not make full use of his power, but will adjust his prices to obtaining a firm hold on the market before he can be caught by competitive supply following quickly at his heels." [Alfred Marshall, *Industry and Trade*, 1919.]

The effect of potential competition (as distinct from actual competition) as a factor likely to influence determination of price and output in concentrated (such as, oligopolistic) industries had been neglected for over thirty years after these words were written. In the last thirty years or so this neglect has been substantially repaired. The process of this repair was begun in a big way by Prof. J.S. Bain and it is continuing to this day. This M.Phil. dissertation outlines these repairs and depicts where this repairing has led to.

Prior to these efforts, the theory of oligopoly was in a fluid state. Theorists were talking in terms of the

need for a case by case approach, which was a proof of the unsatisfactory theoretical situation. A large number of alternative solutions (from Cournot to Stackelberg) had been suggested, each involving a different set of assumptions. It is in this context that Prof. Sylos Labini makes the following comment: "... there is no stopping on the path of conjectural variations. Solutions can be proliferated to infinity on the manufacture of such hypotheses and solutions can become a sort of a profession. It is all remarkably like working out the chess problems in a weekly magazine (white to play and mate in three moves) or, on a higher plane, like writing a manual on chess strategy. The analogy is not formal only, nor we hope - is it disrespectful. A good chess player is much to be admired."<sup>1</sup>

The traditional oligopoly theory was founded on two assumptions: (i) each firm maximizes its profits, and (ii) each firm concerns itself with the repercussions of its actions on the behaviour of other firms already in the market. The first assumption was common to the analysis of all market structures; the second was considered to be the hallmark of oligopoly theory. Once the importance of potential competition was recognized, this shift in focus made it necessary to re-examine both these assumptions. Profit maximization was re-interpreted to mean that each firm would maximize its profits (duly discounted) over the long period, taking into account the repercussions on entry and hence on future profitability of any price policy pursued in the short period. Detailed analysis of various conjectural variations pertaining

to existing firms in an industry had led to nowhere; hence the focus was shifted to potential competition.

In this work, we essentially confine to a discussion of large scale potential entrants. The main focus is on the theoretical implications that follow, once the importance of potential entry is recognized. Some empirical investigations have also been covered. The welfare aspects have not been touched upon at all and the policy implications have been discussed only marginally. We consider situations where there is high concentration on the sellers side, assuming always that there is a large number of buyers. The criticisms that have been levelled at this approach have not been considered in detail. Exit barriers are also left out of the discussion.

The chapter scheme is as follows. The first chapter attempts to summarize the literature from 1949 till about 1960. The second chapter is devoted to reporting the analysis developed on the price-competition from 1960 onwards. The third chapter deals with the literature pertaining to non-price competition that has grown since 1960. The fourth chapter deals with the main conclusions arrived at.

#### Notes and References

1. Sylos Labini, Paulo. Oligopoly and Technical Progress. Harvard University Press, Cambridge, Massachusetts, 1969, p. 20.