LAP

Leadership, Attitude, Performance...making learning pay!

Economics LAP 8 Performance Indicator: EC:012 **Student Guide**

Ready, Set, Compete!

Competition

Objectives:

A Explain the nature of competition.

B Distinguish among market structures.

C Describe the effects of competition in a private enterprise economy.

Table of Contents

MBA Research & Curriculum Center

1375 King Avenue, P.O. Box 12279, Columbus, Ohio 43212-0279
Ph: (614) 486-6708 Fax: (614) 486-1819

You've probably heard the old expression "a little competition doesn't hurt anybody" at some point or another in your life. Competition exists all around us—on the job, at school, in sports, even in dating. Individuals compete for promotions, for the best grades, for starting positions on the football team, and even for the attention of a certain special someone. In most, if not all, of these cases, competition is a good thing. It brings out the best in people. It helps individuals to excel and makes the workplace more efficient, the school better performing, the team higher scoring, and the social scene more exciting. Life would be pretty boring without competition, don't you think?

So what about competition in business? Is it a good thing there, too? It sure is! In fact, it's what turns the wheels of our private enterprise economy. When businesses compete successfully, they grow and prosper, and when they don't compete, they often fail. But what is competition exactly, against whom do businesses compete, and how do they compete against their rivals? Read on to find out!

Competition: Game on!

Competition is the rivalry among two or more businesses to attract **scarce**, or limited, customer dollars. Suppose you owned an online movie- and television-show streaming business—the only business of its type on the Web. If you were the only streaming service online, you wouldn't need to worry about competition. If customers wanted to watch movies and shows online, they would have to come to you. But, in reality, customers are able to stream movies and shows from different sources, including Netflix, Hulu Plus, and Amazon Prime Instant Video. Customers have a choice of sellers, and competition is fierce.

All of these streaming services are trying to capture the attention and dollars of the same group of customers, or market. All of them offer goods or services that will satisfy the same customer needs and wants. As a result, these businesses compete directly against each other.

Direct competition occurs between or among businesses that offer similar types of goods or services. In this case, it's movie- and television-show streaming. However, there are many examples of direct competition. Fast-food restaurants, such as McDonald's, Wendy's, and Burger King, are direct competitors of each other because they all sell hamburgers and french fries. Clothing stores, such as Forever 21, Urban Outfitters, and H&M, are also direct competitors because they all sell clothing for young adults. What direct competitors can you name?

▲ *When businesses offer similar types of goods and services, they are considered direct competitors. Burger King and McDonald's are direct competitors because they both offer hamburgers.*

Competition also occurs among businesses that offer dissimilar goods or services. This is called **indirect competition**, and every seller experiences it. Indirect competition occurs when businesses compete for scarce customer dollars that might be spent on goods or services different from their own. Essentially, each customer has a limited amount of money to spend, and every business—whether it sells food or gasoline or shoes—wants customers to spend their cold hard cash at that particular business and no other. Even though they sell vastly different products, restaurants indirectly compete with gas stations, shoe stores, clothing chains, and an endless number of other businesses. These businesses compete indirectly with each other to get the limited money that customers have to spend.

While businesses are in indirect competition with almost all other businesses in the marketplace, most businesses focus their efforts on competing with their direct competitors. They know who their direct competitors are and plan their competitive strategies with those businesses in mind. This means that a restaurant is more likely to try to take business from other restaurants rather than from a gas station.

How can food trucks demonstrate the difference between direct and indirect competition? Find out with this article by Richard Myrick, "Direct and Indirect Competition for Your Food Truck Business": http://www.dummies.com/how-to/content/direct-and-indirect-competition-for-your-food-truc.html.

▲ *Food trucks face both direct and indirect competition.*

The Price Is Right

When businesses plan their strategies, they may decide to compete in many different ways. The two main ways to compete are through price and nonprice competition. **Price competition** is a type of rivalry between or among businesses that focuses on the use of price to attract scarce customer dollars. This type of competition is successful because customers are often interested in getting goods and services at the most reasonable prices. In addition, if the price of a product is lowered, more customers are likely to purchase it, which can ultimately result in more income for the business. It's a situation where everyone wins—customers get more for their money, and businesses get more income. Here are a few forms of price competition that businesses use to attract customers:

Discount coupons. How often do you pick one pizza joint over another because you have a coupon for "buy one pizza, get another for half price"? Many restaurants regularly offer special discount coupons on selected food items. The coupons encourage customers to buy where they can get the most for their money. Coupons are common in a lot of businesses, including supermarkets, oil-change shops, and dry cleaners.

Special sales. Do you regularly search the newspaper for advertised sales before shopping for a new pair of shoes? Many businesses run sales throughout the year to attract customers looking for good prices. Think of all the sales that businesses use. There are back-to-school sales, Columbus Day sales, President's Day sales, and many more. Payless ShoeSource stores even have a BOGO sale, as in buy one pair, get one pair at half price!

▲ *Special sales are one form of price competition.*

Price matching. A trend among some businesses is to meet their competitors' prices. Lowe's, Best Buy, Staples, and Target all offer to match their competitors' prices. They use slogans like "We'll never be undersold" or "We'll meet or beat any competitor's price." This assures customers that they are getting the lowest possible prices.

Rebates. Some manufacturers also offer to return part of the purchase price a customer pays for a good or service. Rebates have become popular for all sorts of products, ranging from cars to computers.

Price Isn't Everything

What happens if prices are all about the same for a product or are not important? What if customers don't care about discounts and rebates? Then, businesses rely on **nonprice competition**. This happens when businesses compete on a basis other than price to attract scarce customer dollars. Some popular examples of nonprice competition include promoting the following: exceptional quality, special features, trained personnel, outstanding customer service, convenience, modern facilities, and a wide variety of products.

Many times, the quality or new feature is much more important than price. Think about laser eye surgery as an example. While you might be concerned about how much the procedure will cost, you'd probably be even more concerned about whether the doctor is well qualified and using the latest technology. After all, what good is there in having the surgery done if it isn't done right, regardless of price?

www.goteez.com/apples

▲ *Have you ever shopped at a business that promised to meet or beat any competitor's price? This is known as price matching.*

Other times, service and convenience might make the difference. Think about the supermarket industry, which has fairly uniform prices. What attracts you to do business with one supermarket versus another? Is it the bank, the coffee shop, the pharmacy, and the gas station all located in or at the store? Or, is it the longer hours, the self-checkout, and the childcare service available while you shop? At times, it is truly amazing what lengths a business will go to in order to make shopping more convenient and appealing for customers.

Most businesses use a combination of price and nonprice competition. Nordstrom department stores, for example, offer half-yearly and anniversary sales, as well as fantastic customer service. Toyota, on the other hand, offers rebates while emphasizing its vehicles' great gas mileage. Whether it's price competition, nonprice competition, or a combination of the two, the goal is the same. Businesses compete for customers, and they do whatever they can to convince people to buy their products.

Nonprice competition has both pros and cons. Check out the article "Advantages and Disadvantages of Non-price Competition" by Ronald Kimmons to learn more: http://smallbusiness.chron.com/advantages-disadvantages-nonprice-competition-10048.html.

▲ *Many businesses use a combination of price and nonprice competition. A grocery store might offer discounts* and *the convenience of an in-store pharmacy and gas station.*

Summary

Competition is a rivalry among two or more businesses to attract scarce customer dollars. Businesses compete either directly or indirectly. They generally use price or nonprice competition.

TOTAL RECALL

1. What is competition?
2. Explain the difference between direct and indirect competition.
3. Explain the difference between price and nonprice competition.
4. What are two examples of price competition?
5. What are two examples of nonprice competition?

Market Structure Matters

Is competition the same for all businesses? Actually, it's not. The amount of competition that a company experiences depends a lot on how many businesses sell similar products. If a lot of businesses sell the same thing, then there is going to be a lot of competition. But, if only one business sells a particular product, then it won't have any competition at all.

We use the term **market structure** to describe the type of market, or environment, in which businesses operate. There are four main types of market structure: perfect competition, monopolistic competition, oligopoly, and monopoly. The market structure for an industry depends primarily on how many sellers exist in that market. Let's take a closer look at each type of market structure.

Perfect competition. For perfect competition (also known as pure competition) to exist, many businesses must sell identical products to many buyers. Because many businesses all sell the same product, there is a plentiful supply of that good or service. All businesses compete equally and charge about the same price, which means that no seller has an "edge" on the others. This sounds pretty good in theory, but does perfect competition exist in the real world? Not really. It's more of a benchmark to compare real market structures against. The closest that we come to perfect competition in the real world is in farm commodities, such as wheat and corn. These producers sell the same product at pretty much the same price using the same technology. This results in a market structure closely resembling perfect competition.

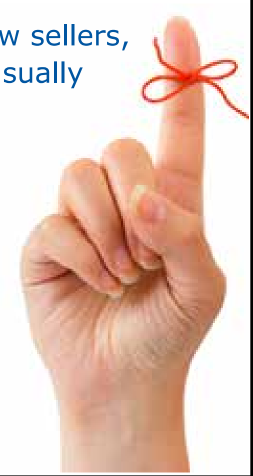
Types of Market Structure

Perfect competition:
Many businesses sell a lot of identical products for about the same price to many buyers (also known as pure competition)

Monopolistic competition:
A lot of businesses sell similar products that have only a few differences

Oligopoly:
There are relatively few sellers, and industry leaders usually determine prices

Monopoly:
A market is controlled by one supplier, and there are no substitute goods or services readily available



iStock/Thinkstock

Learn about how fishermen can provide an example of perfect competition with this video, "Perfect Competition," from Investopedia: http://www.investopedia.com/video/play/perfect-competition-0/.

Monopolistic competition. This is the type of market structure you're most likely to find in a private enterprise economy. There are a lot of businesses selling similar products that have only a few differences. Think of shampoo, cosmetics, and running shoes. All of the shampoo being sold today is relatively similar, as are the cosmetics and running shoes. Sellers lower their prices to increase sales and try to differentiate their products from their competitors' to attract business. Producers use brands, packaging, advertising, special features, and service to make their goods and services stand out. Such price and nonprice competition goes a long way toward helping businesses succeed in an environment of monopolistic competition.

Oligopoly. In an oligopoly, there are only a few businesses that sell all of the products. As a result, these businesses are relatively large and have a lot of control over the market and product prices. It is difficult for new businesses to enter the market and compete in an oligopoly, but an oligopoly does have its advantages. When only a few large businesses compete, each business has time to devote to innovation and the reduction of production costs. What U.S. industries are oligopolies? The automobile industry, the pharmaceutical industry, and the oil industry. Each contains a limited number of players who have a lot of control over what is produced and how much the consumer must pay for the products.

Learn more about how oligopolies work by watching this video, "Oligopoly," from Investopedia: http://www.investopedia.com/video/play/oligopoly/.

▲ *The U.S. automobile industry is considered an oligopoly because there are only a few businesses that sell all of the products. What other oligopolies can you think of?*

Monopoly. A monopoly exists when the market is controlled by one business, and there are no substitute products readily available. In this type of market structure, competition does not exist.

Monopolies are usually not allowed to exist in a **private enterprise system** because they can cause many problems. Monopolies have a tendency to raise prices, produce less, and prevent new businesses from entering the market. However, in some cases, monopolies do legally exist. When the government feels that one large company can serve customers more efficiently than several small ones, it may allow a monopoly to exist. These monopolies, known as **regulated monopolies**, are necessary to keep prices and costs down. They operate under close government supervision and must obtain approval to raise rates.

▲ *Garbage collection is one of the few regulated monopolies in the United States.*

There aren’t many regulated monopolies in the United States today. The few that exist include electricity distribution, natural gas distribution, and garbage collection. Rather than allowing multiple electric companies to string or bury their lines all over a city so that all can compete for the residents’ business, many local governments have determined that it is in the public good to allow one company to handle electricity distribution for an entire area. In such instances, government has determined that it is to our benefit as consumers and city residents to allow a monopoly to exist.

Some people think that Amazon.com is a monopoly. However, this article by Chris Matthews, “Amazon Isn’t—and Likely Never Will Be—a Monopoly,” argues otherwise: http://fortune.com/2014/05/28/amazon-isnt-and-likely-never-will-be-a-monopoly/. What do you think? Based on what you’ve just read, does Amazon qualify as a monopoly?

The Role of Government

In a private enterprise system, governments regulate businesses to encourage ethical and legal competition. Several pieces of federal legislation have been passed over the years to promote competition, which can help to keep prices down, quality good, and production efficient. These acts include:


iStock/Thinkstock

- **Sherman Antitrust Act (1890)**

  Prevents monopolies from forming and hinders **price fixing**

- **Clayton Act (1914)**

  Prevents specific business actions that might restrict competition, such as **tying agreements** and **exclusive agreements**

- **Federal Trade Commission Act (1914)**

  Created a regulatory agency, the Federal Trade Commission (FTC), which monitors business activities to prevent unfair competition

- **Robinson-Patman Act (1936)**

  Prohibits **price discrimination** so that all businesses purchasing similar amounts and types of products would be charged the same price

- **Celler-Kefauver Antimerger Act (1950)**

  Protects competitors from takeovers if the acquisition would hinder competition

The video "A Brief History of the Birth of the Federal Trade Commission" from the FTC explains how the government uses these pieces of legislation to regulate competition: http://www.youtube.com/watch?v=NssfPApe5iQ.

Summary

A market structure is the type of market, or environment, in which businesses operate, and it is primarily based on the number of sellers in the market. There are four types of market structures: perfect competition, monopolistic competition, oligopoly, and monopoly. The U.S. government has passed several pieces of legislation to promote competition.

TOTAL RECALL

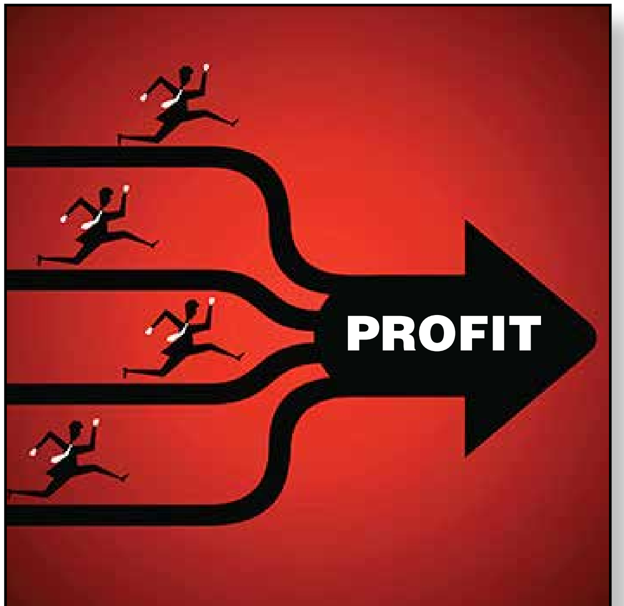
1. What is perfect competition?
2. What is monopolistic competition?
3. What is an oligopoly?
4. Explain the difference between a monopoly and a regulated monopoly.
5. Explain the purpose of U.S. legislation that regulates businesses.

The Gray Zone

Not so long ago, the hardware store industry was populated by many small, privately owned businesses. Every small town had at least one local hardware store, and larger cities had several of them. In almost every case, each store was owned by a different individual or small company.

Today, though, the industry is dominated by a few corporate giants, including Lowe's, Home Depot, and Menards. These "big box," do-it-yourself stores, as they are sometimes called, entered the hardware store industry with a vengeance and have all but wiped out the small, privately owned hardware stores. Why has that happened? How did chains like Lowe's drive the small stores out of business? Is that fair? Is that ethical? Was it right for the government to let so many small, privately owned businesses disappear? Should the government step in and stop the big-name hardware store chains from getting even bigger?

Competition: A Win-Win Situation



iStock/Thinkstock

▲ *Businesses work hard to beat their competitors, attract the most customers, and make a profit.*

Without competition, the private enterprise system would not exist. In this type of economic system, all of the buyers and sellers play an important role in controlling the economy. They interact in the marketplace to determine what products will be produced and what prices will be charged for those products. It is competition that makes available the goods and services that customers want at prices that customers are willing to pay.

In a private enterprise system, most businesses have several competitors. Some businesses, such as drugstores, have hundreds of competitors. There are probably several national chains in your area, as well as stores operated by supermarkets, and possibly even independently owned stores, too. The competition among them is fierce. You might think all this competition is bad for business, but actually it is quite good.

Businesses Win!

Competition benefits business in several ways. One way is by encouraging new businesses to enter the marketplace. Think about the copy machine industry. The Xerox company was the first to develop the plain paper photocopier, back in 1959, and was able to sell it successfully to many customers. The product became so popular that more and more customers wanted it. Because of the demand, several other companies developed similar products over the years and began selling them as well. These companies, including Ricoh, Minolta, and Sharp, saw an opportunity and decided to compete with Xerox. As a result of competition, new companies were created.

Competition also encourages businesses to operate as efficiently as possible. For example, when competing businesses enter the marketplace, they often try to spend less on producing the products in order to sell them at a lower price. They look for faster, more effective methods of production to lower costs. This also forces the original company to produce more **efficiently** to be able to remain competitive. The overall result is that all the companies reduce costs and preserve resources.

This leads to one of the most important benefits of competition—profit. Businesses work hard to beat their competitors and attract the most customers. Those that produce efficiently and sell effectively are able to make a profit. It is the hope of making a profit that encourages businesses to operate.

▲ *Due to competition, technology companies must constantly introduce new products that benefit customers.*

Customers Win!

Competition also benefits customers. If a business is going to attract customers away from other sellers, it must try to:

Develop new products to meet customers' needs. Technology companies that want to stay ahead of the curve are constantly introducing new products—they have to if they want to compete with other companies! These innovations mean there is a steady flow of new products for customers to buy and use.

Maintain or improve the quality of existing products. In the hunt for customer dollars, businesses continually try to upgrade their existing products. Just think about smartphones. Companies are always trying to create newer, better phones that are able to perform more tasks and make customers' lives easier. The benefit to the customer is a better product.

Provide more and better services. Competition encourages businesses to offer more services. If all other factors remain the same, the availability of services can attract and keep customers. You might have noticed that many auto-repair shops provide customers with free transportation to and from work. Customers enjoy the convenience at no additional cost.

Provide wider selections of goods or services. Because there are many types of customer needs, businesses try to offer many types of goods or services. An example of a business that has worked hard to provide a wider selection of goods is Wendy's fast-food restaurant. Instead of offering only hamburgers and fries, Wendy's menu includes chicken sandwiches, chili, baked potatoes, salads, and desserts. The restaurant chain's hope is that most, if not all, customers can find something they like on the menu.

Keep prices down. Price is often a main factor when customers decide what and where to buy. When given a choice between two similar products of the same type, customers often choose the lower priced one. Therefore, competition forces businesses to keep their selling price as low as possible. As a result, customers get a good value for their money.

"At Green Acres Repair we offer free shuttle service to get you where you need to be while we work on your car."

www.greenacresrepair.com

▲ *Have you noticed that many auto-repair shops provide customers with free transportation to and from work? Services like these are just one benefit customers receive from competition.*

Society Wins!

Competition also benefits society. Because of competition, businesses develop new and improved products that make people's lives easier and more convenient. Think of all the frozen foods that can be microwaved and ready to eat in minutes. Think of all the businesses that provide housekeeping services, pet-walking services, or child care. As a result, people enjoy a high **standard of living**.

Some of these products even help people to be healthier and live longer. Pharmaceutical companies, for example, continuously do research to develop new drugs to prevent or cure diseases. In addition, health spas and workout facilities are available everywhere.

Competition also helps to create new businesses that make jobs available to a lot of people. Consider the Internet and the growth of e-commerce. Many businesses in that industry didn't even exist a decade ago. Now, there are endless web-based companies employing a huge number of people. This leads to a prosperous society in which people have jobs, earn an income, and spend money for more goods and services. This type of prosperity usually does not exist in economic systems without competition.

www.theorganicbistro.com

▲ *Products like frozen foods make people's lives easier. Convenience is one of the benefits of competition!*

Summary

Competition is essential in a private enterprise society, and it benefits businesses, customers, and society. Among other things, it keeps profits up, prices down, quality good, production efficient, and the standard of living high.

TOTAL RECALL

1. Explain three ways that competition benefits businesses.
2. Explain five ways that competition benefits consumers.
3. Explain three ways that competition benefits society.

Make It Pay!

Think about the business where you work. If you don't currently have a job, think about a business where a parent or friend works. Who are the business's direct competitors? How does your business directly compete against its rivals? What forms of price and nonprice competition does your business use to attract customers? Are these forms of price and nonprice competition successful in attracting people to your business? How could the business better compete against its rivals in the marketplace?

