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Monopolistic Competition? The Rise of Brand-Chain Competition and Unresolved Social Questions

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ABSTRACT
Imperfect competition in microeconomics has been known as "Monopolistic Competition" since the near simultaneous release of books by Joan Robinson and Edward H. Chamberlain in 1933. The topic is still taught in economics texts and classrooms to this day, despite little evidence that it now exists in the industrialized world. Oligopolies have moved into this highly competitive field via Brand-Chain Competition. In Brand-Chain Competition, the Oligopoly uses its deep pockets to fund research and development of new products which are sold through brand-names. While the high barriers to entry remain, and the Oligopoly faces little competition from additional firm entry into the industry, entry into a particular product market is rather simple, and highly competitive. Robinson and Chamberlain were correct that economic profits only occur in the short-run due to this high competition. They were incorrect on who the end-game players would be. Rather than massive numbers of sellers, there are massive numbers of brands and few parent corporations. These firms send out a new products via brands, with the intent to earn excess profits only until the competition can produce and market a similar product, which reduces demand for the original firm's product in the long-run. The brand then responds by releasing a new or improved product from its chain of products, and the short-run begins again. These changes are so new, the social impacts are still a question

KEYWORDS: Imperfect markets; Monopolistic Competition; Brand-Chain Competition; Market Consolidation; Oligopoly; Mergers; Monopoly Power; Global Corporation; Lack of Competition

INTRODUCTION

Times have changed since Joan Robinson (1933) and Edward H. Chamberlain (1933) introduced the concept and title of "Monopolistic Competition," respectively, and nearly simultaneously. Both authors published books on the subject of imperfect competition which flourished in that pre-WWII period. Each work describes how this real-world Monopolistic Competition differed from the closely related, yet imaginary, state of Perfect Competition through product differentiation and yet both market conditions still met the same conclusion in the long run. Robinson and Chamberlain accurately depict much of the market conditions faced by businesses of that era. Ever since, Monopolistic Competition has been consistently taught in Microeconomics principles classrooms and textbooks.

Under the theory of Monopolistic Competition, there are many small businesses, and there is also an absence of barriers to keep out competitors, or conversely, to keep businesses from leaving the industry. Even trademarks cannot stop a potential competitor from starting a similar business. The competitor could simply sell a similar product under a different trademark. In this highly competitive market system, each company strives to differentiate what it sells from all others in the market. Usage of everything from advertising, product

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differences, delivery options, and packaging are all ways that businesses differentiate themselves. Each firm has only a short window to make an economic profit[1]. This window, called the short-run, is a time in which businesses have at least one fixed input. In other words, it is the time *before* competitors can gear up to enter the market and compete directly. In the long-run, when competitors enter the market, the competition lowers demand for the original firm's product. Firms with negative economic profit leave the market, and in the long-run all firms make only zero economic profit. But this is a market condition that has rapidly become rare in the industrialized world.

Although the massive consolidation of market power amongst fewer and fewer firms worldwide has been the subject of much study and discussion in economic and financial circles[2], we have yet to see a coherent explanation of the impact this increased monopoly power has had on imperfectly competitive markets, such as Monopolistic Competition. These markets have changed, and in the industrialized world, at least, it is not beyond reason to suggest that Monopolistic Competition may not now actually exist in the way conceived by Robinson and Chamberlain.

Despite these recent changes, the textbooks[3] still teach Monopolistic Competition as it was originally conceived by Robinson and Chamberlain, and it is in the principles classroom where the need for an updated explanation of imperfect markets first became apparent. If a good professor teaches with examples, something has gone awry when it becomes nearly impossible to recognize and present real-world examples of the textbook explanation for imperfect markets; *id est*. monopolistic competition. To give a classroom example of firms with products that can achieve greater than normal profits only in the short-run, it now seems the most workable examples are of new products from oligopolies, which were quickly imitated by other oligopolies. Wait, what? Indeed, today's example of markets where there are short-run profits and competitors taking away the long-run demand is coming from oligopolies, in the form of competition in the realm of new products and brand names. It was not always this way.

Oligopoly has traditionally been viewed by economists as *the other* real-world market condition[4]. The former is the opposite real-world condition from Monopolistic Competition, which is a market with few barriers to entry or exit, composed of numerous small companies; each of which cannot make economic profits in the long-run. Oligopoly differs, therefore, in all these ways. There are a few, large, inefficient firms that are interdependent of each other, as well as immense barriers to entry into the industry. By keeping out new competition, these barriers to entry make the possibility of long-run economic profits possible.

In this paper, we show that there has been a sea-change in the corporate world, such that oligopoly now exists with more monopoly power than before. We also argue that oligopoly has

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[1] Zero economic profit is the same as zero accounting profit plus just barely enough additional accounting income (normal profit) to justify continuing in business.

[2] Discussed in more detail in the next section of this paper.

[3] As a much younger researcher, I once made the mistake of sending an article criticizing the mathematical treatment of apparent and unexplained division by zero in the explanation of elasticities in economic textbooks to an editor who had also written an economic text. It still is not clear why he was angry that his text was not mentioned in the article, however, lesson learned. No listing of specific texts found here. Should the curious reader care to check, you will find the topic of Monopolistic Competition is still found in most currently published Microeconomics principles texts.

[4] On a spectrum running from *Extreme Competition* (Perfect Competition) to *Extreme lack of Competition* (Perfect Monopoly), the extreme ends of the spectrum are not described as real-world, much like in mathematics, where $-\infty$ and ∞ are not defined as real numbers. Oligopoly is the real world market scenario closest to Perfect Monopoly.

successfully replaced monopolistic competition in the highly competitive arena of imperfect competition; a claim that seemingly is at odds with itself, but is logically described herein.

Organization of this paper flows with argument. To start the point that the system has indeed changed, and that it is time to re-define the area of market activity known as Monopolistic Competition, we first present evidence of the recent immense change in the degree of market concentration in Section I. Additionally, Section II provides support for the idea that Oligopoly can exist and act across the wide spectrum from the highly concentrated arena, where it is expected to exist, to the seemingly improbable competitive section of the spectrum wherein monopolistic competition has traditionally been in operation. (Barber, 1996) Section III explores our argument, and Section IV concludes the paper.

SECTION I. INCREASING MARKET CONCENTRATION

Oligopoly Power (often described as *Monopoly Power* or *Degree of Market Concentration*), is measurable by more than one method. Probably the most well-known measure, the Herfindahl-Hirschman index (HHI)[5], measures the degree of concentration within a particular industry. When measuring the increase in monopoly power of massive multinational corporations, however, the HHI is inadequate, since these global companies often participate in multiple industries.

Another measure of market power is the Lerner index. Mathematically related to the price elasticity of demand, it has also proven somewhat problematic in empirical study across industries (Lerner, 1934). Michael Kalecki (1954) measured the power to markup price over the cost of materials and labor, but this method seems heavily dependent on institutional factors and, like the HHI, may not be usable across industries or national borders (Reynolds, 1983). Another way to measure such power is to compare the gross profits of giant firms with the gross profits of all firms in the economy over time (Schutz, 2001). While this method crosses industry lines, it does not cross beyond national borders without difficulty.

Not all measurement techniques have the above shortcomings. The use of Return on Assets as a measure of market power is one example, although it does assume homogeneous accounting standards and most importantly, usage or enforcement of such standards, across national borders (Barber, 1996).

One type of study that seems to have fewer drawbacks is a yearly counting of the number of registered public corporations. If there are less corporations, there is arguably less competition. This method would require a check of the number of private corporations, to ensure that the public corporations are not being replaced by privately held ones (Grullon, 2017).

There have been numerous studies, some in the popular press, and many in the economic literature showing support for the conclusion that Corporations are becoming larger, more powerful, and fewer in number. The changes have been so rapid in recent years, unfortunately, that even a very good study from as little as eight years ago is already very much

[5] The U.S. Justice department, other Federal Agencies, and many economists use HHI to determine the amount of market concentration, or monopoly power that exists in an industry. It is the sum of the square of each firm's percent of market share. Example: a monopoly has one firm with 100 percent market share. HHI = 100^2 = 10,000. Another example: an industry with 100 firms, each with 1 percent of the market. In this case:

$$HHI = \sum^{100} 1^2 = 100$$

out of date. Market structures have been changing quickly, and contemporaneous data is essential.

Probably the most current and comprehensive study attempting to analyze the degree of market concentration is by Grullon, Larkin, and Michaely (2017). Using and/or referencing all of the above methodologies, they find that "three-fourths of U.S. industries have experienced an increase in concentration levels over the last two decades" while "firms in industries with the highest increase in product market concentration have enjoyed higher profit margins, abnormal stock returns...suggesting that market power is becoming an important source of value." This result is a direct product of publicly traded firm consolidation "into larger entities," that they conclude "has weakened competition."

SECTION II. TYPES OF COMPETITION

For most economists, a movement towards larger and larger multinational firms, each holding increasingly more monopoly power does not bring to mind the concept of an increase in competition. There is, however, a different concept of competition, one described by Joseph Schumpeter (Reisman, 2004) and Milton Friedman (1962). Friedman describes it as follows:

> *Competition has two very different meanings. In ordinary discourse, competition means personal rivalry, with one individual seeking to outdo his known competitor. In the economic world, competition means almost the opposite. There is no personal rivalry in the competitive market place. There is no personal higgling. The wheat farmer in a free market does not feel himself in personal rivalry with, or threatened by, his neighbor, who is, in fact, his competitor. The essence of a competitive market is its impersonal character. No one participant can determine the terms on which other participants shall have access to goods or jobs. All take prices as given by the market and no individual can by himself have more than a negligible influence on price though all participants together determine price by the combined effect of their separate actions. Monopoly exists when a specific individual or enterprise has sufficient control over a particular product or service to determine significantly the terms on which other individuals shall have access to it. In some ways, monopoly comes closer to the ordinary concept of competition since it does involve personal rivalry.*

Friedman's use of the term "monopoly" in the above quotation is a reference to monopoly power. A small group of Oligopolist firms, each having massive monopoly power, would be rivals and thus would compete in this way, rather than the standard type of competition of many insignificant nameless individual firms. Schumpeter describes how this "competitive pressure" will give a sense of urgency to the entrepreneurial spirit and provide "a perennial gale of creative destruction" which he declares to be a process imbedded in capitalism (1942). Schumpeter speaks of social scientists and theorists, who only see the current business "situation as if there were no past or future to it" and this lack of insight prevents them from realizing how things came about or where capitalist systems are going. This lack of understanding, he states, leaves them without understanding of "how it creates and destroys" these very systems.

In Oligopoly, for instance, firms are interdependent, given the immense size and small number of the firms in the industry. When one firm makes a change, other firms must react to the impact of this change. If a firm becomes larger or more efficient, the system has begun to change, others must follow this change or be left in the past.

Through Schumpeter's lens, the massive consolidation into fewer and fewer large corporations that we are experiencing would not be viewed as a form of global collusion, but instead as a form of response to the "perennial gale of creative destruction," as each firm attempts to adapt to the imminent and personal destruction posed by the entrepreneurial creativity of others. Firms will compete against their rivals to become the most efficient, and in that quest, will search globally for the cheapest resources, whether labor or capital without loyalty to any one country or culture (Braverman, 1974).

With massive change comes massive impact. The result will be a great equalization of wages and other resource prices globally. As firms become international, the anti-trust laws of any one country would not apply. This makes it harder to control monopoly power within the framework of any one government. Ravi Bhandari described this resulting new economic environment, stating "the bigger issue today is that nations are not all that important. We have moved from religious organizations ruling the world to different types of governments…to now multinational corporations that rule the world." (Bhandari, 2013)

Here, therefore, is the end-game of imperfect markets; as forecasted by Baran and Sweezy for the future of oligopoly (1966) . It is a reliance on marketing, sales, and product differentiation in the short run, and it now exists as described below.

SECTION III. THE END-GAME: BRAND-CHAIN COMPETITION

Now what poses as monopolistic competition is actually competition of an unexpected sort. It is competition of rivals, rather than the masses, and is played out in the short run by the brand-chain competition of oligopolies. The short run is where there are profits. New and improved. New packaging, new products, all designed to get in and get out with a profit in the short run, products living for the short run, because when the competition gets into the market, the profits dry up. The way in which oligopolies can make money in the long run comes from their intrinsic massive economies of scale and scope, and the usage of research and development to keep the assembly line of new products repeatedly moving into the marketplace for a short lived run. New products, new packaging, new differentiation of any kind are found here. It is as dynamic and exciting as it is vicious. While consumers see many products and brands, the number of parent corporations is by comparison quite small. Some brands compete against each other despite the fact they are produced by the same parent company, a form of vicious market cannibalism designed to appeal to different market targets. It is an industry where being on the cutting-edge is essential. Firms seek to always be in the short run, for that is where profits are made. The Oligopolist must be quick and have deep pockets. But the rewards can be enormous.

This is what has become of the market envisioned by Robinson and Chamberlain in 1933. They saw a market of many small companies, competing in a world of few barriers to entry. This market is now superseded by a much smaller number of massive companies, competing in a world with massive barriers to entry, competing with many brand-chains, producing products designed to succeed only until the competition catches up, when a new product or product change will be inserted into the market in its place. The original findings of Robinson and Chamberlain remain. In imperfect competition, economic profits are only possible in the short run, both old and new. Competitors eventually enter and take away demand for the product in the long-run. Only the players have changed.

SECTION IV. CONCLUSION

In the industrialized world, Brand-Chain Competition has replaced Monopolistic Competition in the spectrum of possible market environments that ranges from Perfect Competition

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(theoretical) to No Competition (theoretical). Formerly two existing systems were believed to actually exist in the real world; Oligopoly, which inhabited the spectrum close to Perfect Monopoly, and Monopolistic Competition, which resided on the other side of the spectrum, nearest Perfect Competition. Now, only Oligopoly exists as a functioning real world system in many industrialized countries, and it exists along the entire spectrum inside of the theoretical endpoints. Using their massive size to fund research and development, and develop a continuous stream of new products, new flavors, or improvements for sale through trademarked and recognizable brands, these corporations seek short run economic profits until competitors can react with their own competing products. At that time competitors enter and take away demand for the existing product, reducing economic profit to zero. Almost immediately, another product that had been waiting in the brand chain is released into the market, hopefully also to bring in economic profits. If a new product fails, it is also replaced in the marketplace from the chain of waiting products the brand is waiting to release.

Oligopoly competes for short run profits but also inhabits the traditional non-competitive end of the economic spectrum. Huge barriers to entry prevent new competitors from entry on the same competitive level. A savvy small entrepreneur can enter the market with a new product, but will likely not have the resources even with venture capital funding to produce research and development of an entire chain of products. The small firm's short-run economic profit will be eliminated by similar products from larger corporations and at that point their brand name may be worth more in sale to an Oligopolist than the original product would be on the market.

In conclusion, it should be mentioned that there is tremendous potential for social science research about this phenomenal economic change. One area of study would be the impact of the increased size of corporations on the many areas of civic life around the world. Are these mega corporations now able to influence elections, overthrow dictators or influence politicians already in office in directions adverse to the interests of citizens and workers of that country? Have they already done so? This is a difficult question for academics to study and to answer, given the existence of trademarks and rabid corporate attorneys. One must take great care in what one says in writing, even if based in truth, given the immense deep pockets of the massive corporation versus those of the academic researcher. And if a large corporation has the resources to influence governments, they also have the resources to keep the story out of the media[6].

Another area of great potential is the impact on inequality. If the system requires more and more capital to enter and stay successful as an entrepreneur, does this serve to keep some people on the lower end of the income distribution? What has been happening to income inequality while this expansion of monopoly power has been occurring? Are there fewer or are there more people proportionally who are super rich? What about the inverse connection between inequality and rule of law? (Vieira, 2008) Are people of extreme wealth becoming more immune to obeying the law? Or is the equalization of wages worldwide doing more to alleviate poverty than any damage to the rule of law[7]?

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[6] I happened, through personal contacts with well-placed Nigerians, to hear about the Ogoni Incident in Nigeria the day after it happened in the early 1990s. Despite the horror of the event, a two week search of American News Sources turned up no stories on the event. In fact, the only story I found at the time was in the *Economist*, a British publication. After the internet became a viable platform, my searches continued, but even to this day, search engines including Google present a link that goes to Shell Oil Company press relations as first option in the list. In November 2017, the BBC came out with a story saying that Amnesty International was investigating Shell about the Ogoni incident, more than a quarter century after its occurrence (2017). It can be difficult to investigate corporate malfeasance that is not reported in the media.

[7] Also see Sumner and Huo (2014) for background on the importance of Rule of Law.

What about consumer issues? Is there a reduction in the ability of the consumer to register a complaint or fight back against unfair business practices when the seller is a global corporation versus when the seller is a smaller regional producer subject to the laws of the consumer's own country? Is there a reduction in quality available to the consumer due to less true choices for parent company suppliers and also due to less sense of care caused by greater distance from the consumer, both in corporate size and in geography? Or is any potential damage that a potential lower quality product produces outweighed by lower prices stemming from this new global system?

And then there is potential research in the field of financial capital.[8] While financial capital has been documented as a major factor in the growth of the corporation, it would be fascinating to discover how the growth of monopoly power for the Oligopolist has impacted the small entrepreneur's access to financial capital.

The environment is an area where the international corporation has the ability to use its global status to acquire refuge from the environmental legalities and high associated costs of individual nations. By producing in countries with low enforcement of environmental cleanliness standards, firms can achieve lower costs per unit sold, and then these cheaper products can be sold back into the countries with higher enforcement standards. An interesting research area would be a comparison of costs versus benefits to consumers for these policies, on a national and an international scale.

The growth of the mega-corporation and the advent of brand-chain competition has had a large effect upon the world. Massive change of any sort produces social impact. Often the winners are obvious but the losers can be hidden. We must discover the interconnection between economic and the societal changes, and seek to understand the costs and benefits if we are to make wise decisions about the future.

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[8] There are numerous sources on how financial capital impacts the growth of corporations, from the forward looking Karl Marx (2010) to the current work of Thomas Piketty (2014). Another excellent reading is Foster, McChesney and Jonna (2011).

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