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economics sample 2

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# INTRODUCTION

The grocery industry in Australia at present is one of the most concentrated industries of the world. The industry is marked by the presence of two supermarket giants namely Woolworths and Coles who control around 80% of the total shelf space (Jenson 2011). This market dominance and a duopolistic operation often create difficulties for other players in the grocery industry of Australia. Both these players have been criticized time and again for various methodologies that they implement in order to push other players out of the market and the resulting effects of this duopoly on consumer choice, prices that need to be paid and overall economy of the nation.

# MARKET DUOPOLY

At first sight, it appears that both these giants provide great comfort to the residents of Australia by slashing grocery prices at a time when the cost of everything is shooting up. A closer look at these price cuts however brings us to a realization that they must be coming from somewhere in the supply chain.

Taking the industrial economics point of view into consideration, the continuing price war among the two supermarket giants can at first sight be compared to the Bertrand completion model. According to this model, market players pertaining to the same industry respond to each other via price modulations. The underlying assumption of the model is such that the competitor that succeeds in offering the lowest prices to consumers shall possess control of the entire market and its associated benefits. According to the model an equilibrium condition is achieved when prices equivalent to marginal costs are set and no economic benefits are derived (Foley 2012).

The condition of deriving no economic profits however clearly indicates that the model does not accurately map the condition of these major players as both of them reported a significant increase in their economic profits over the last year. The fact that both competitors have found a way of increasing their economic profits leads us to a conclusion that they do not bear the expenses of slashing prices for consumers.

Negotiation in trading terms forms a possible avenue for these supermarkets to derive benefits. Since they capture almost the entire market shelf space, they can create product demands thus leaving very little bargaining power with suppliers of the industry (Anon 2012). With the help of their prominent power, they are able to force suppliers to operate on marginal profits and accept more blatant credit terms. Additionally, it is increasingly becoming difficult even for large players of branded products such as Coke to negotiate with these colossal players. This price war and controlling of shelf space by these large players has made it virtually impossible for other players to survive in the grocery industry thus leading to a situation where market prices are majorly controlled by these players (Anon 2012). Market duopoly by these two firms is also playing a significant role in dictating prices to producers and giving them a hard time.

Overall, the two competitors have substantially affected the industry economy by reducing revelry in the industry. Both Woolworths and Coles have been acquiring competition and gaining strength across the entire retail market in order to successfully reduce the likelihood of attacks from emerging competitors. Additionally, they have substantially increased their bargaining power thus leaving little or no options with the producers and suppliers of the industry. Further, by acquiring an immense power they have reduced product choices that are available to consumers and store operators. Lastly, these players have succeeded in building substantial barriers to entry in the industry.

This supermarket duopoly is not just hurting members of the supply chain but also the national economy as a whole.

Most of the products sold in these supermarkets are private labels. In other words they are cheap substitutes of branded quality products and are usually the supermarket’s own produce. Further most content for manufacturing these private label products comes from overseas markets and is a lot cheaper than standard raw materials available in Australia (Foley 2012). This results in the transfer of a significant amount of Australian consumer’s money towards importing cheap raw materials. This transfer although profitable to both supermarket chains, hurts the national economy as an increasing amount of money is transferred out of the nation.

The existing duopoly among these supermarket chains also hurts the Australian national economy by increasing the amount of prevailing unemployment (Foley 2012). Acquiring of immense bargaining power and building substantial barriers to entry by these two major players have led to driving many other market players out of business. This in turn has resulted in workers employed with these players losing their jobs (Foley 2012). Thus, government money had to be diverted towards providing alternative employment opportunities to these workers. Further, if the current duopoly continues and the supermarket chains succeed in attaining 100% shelf space, the number of market players going out of business, the rate of unemployment and the government money needed in order to take care of these workers and their families will increase.

Further, the supermarket duopoly has a potential to severely hurt the Australian economy by chagrining extremely high prices once they achieve 100% shelf space (Hernandez 2008). At present the situation is such that both the supermarket chains are offering extremely low prices to consumers at the cost of industry producers and suppliers. This is being done in order to acquire more and more shelf space and achieve complete market dominance. Once this is achieved, prices in the grocery industry shall be completely controlled by these two players (Hernandez 2008). At that point, these players would be free to charge whatever they want from consumers. This would hurt the national economy as suppliers and producers will have to operate on dictated terms and consumers will have to pay a heavy amount in order to obtain food products.

Market duopoly of the two supermarket chains also has the potential to negatively impact the Australian economy by breeding poor health (Hernandez 2008). The focus of these supermarket chains largely rests on acquiring market share by pushing players out of competition and flooding the market with private labels. Under these circumstances, a little emphasis is laid on the process with which food products are grown, manufactures, stored or delivered (Hernandez 2008). This might lead to low quality food products being delivered to consumers thus negatively affecting their health. Further, since the choice available to consumers is limited the negative health impacts of these low quality food products can be potentially large (Hernandez 2008). Thus in turn would hurt the economy as the government would have to make an increased spending for providing medical and health benefits.

# CONCLUSION

The two supermarket giants have clearly gained a lot of power with a potential to drive players out of business and regulate market prices. This kind of a duopolistic trend is not just placing pressure on industry producers and suppliers but also has the potential to negatively impact the national economy. In order to control the situation, the ACCC should place appropriate restrictions on the maximum amount of shelf space that can be possessed (Jenson 2011). Further, regulations need to be implemented for increasing the level of competition in the industry and distributing power among players.

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