FAQ:

(1) In which market barriers to entry exist?

A. Monopoly.

(2) Write the Bain's definition of barriers to entry.

A. According to Bain, "A barrier to entry is an advantage of established sellers in an industry over potential entrant sellers, which is reflected in the extent to which established sellers can persistently raise their prices above competitive levels without attracting new firms to enter the industry."

(3) Explain the meaning of barriers to entry.

A. Barriers to entry are the obstacles that make it extremely difficult for small or startup enterprises to get a foothold or thrive in a market or industry. The existing competitors are extremely big, dominant or established, making it virtually impossible for anybody new to come onto the scene and gain market share. In other words we can say that the existence of high startup costs or other obstacles that prevent new competitors from easily entering an industry or area of business. Barriers to entry benefit existing firms already operating in an industry because they protect an established company's revenues and profits from being whittled away by new competitors. Common barriers to entry include special tax benefits to existing firms, patents, strong brand identity or customer loyalty, and high customer switching costs.

(4) Give an Example of barriers to entry.

A. Consider the following example:

An incumbent company fearing entry installs extra machinery. A potential entrant knows that the company will have a lower variable cost in the future. The low cost implies that the incumbent would set a lower price if entry occurs than if the incumbent did not have the extra machinery. As a consequence of the incumbent's extra capacity and lower cost, the potential entrant would receive a lower price. Under the right conditions, the entrant's price would be too low to cover all of its costs, so it would choose not to enter. Thus the incumbent's decision to install the extra machinery prevents entry. Further, as a result of having the extra capacity, the incumbent sets a lower price today, even though entry has not and will not occur. Potential competition has disciplined the price. If there were no possibility of entry, the incumbent would not choose the extra capacity, would have a higher level of cost, and would set a higher price. The possibility of entry limits the price that the incumbent will charge, which is why the phenomenon is called limit pricing.

(5) Explain the assumptions of Bain's theory.

A. The assumptions of Bain's theory are as follows:

(1) There is a determinate long-run demand curve for industry output, which is unaffected by price adjustments of sellers or by entry. Hence the market marginal revenue curve is determinate. The long-run industry-demand curve shows the expected sales at different prices maintained over long periods.

(2) There is **effective collusion** among the established oligopolists. It means that collusion will lead to higher gain.

(3) The established firms can compute a limit price, below which entry will not occur. the computation of limit price depends on:

- **(a)** On the estimation of costs of the potential entrant
- **(b)** On the market elasticity of demand
- **(c)** On the shape and level of the Long term average cost
- **(d)** On the size of the market
- **(e)** On the number of firms in the industry

(4) Above the limit price, entry is attracted and there is considerable uncertainty concerning the sales of the established firms.

(5) The established firms seek the maximization of their own long-run profit.