Market Concentration

Market power, competition and efficiency in concentrated Australian industries

How to use this guide

Information in this guide is colour-coded and labelled. Each coloured box carries a word label as well as a colour, so you can use it whether or not you distinguish the colours easily.

KEY DEFINITION	The precise meaning of a syllabus term. Learn the wording.
AUSTRALIAN CONTEXT	Real Australian evidence or data you can quote as examples.
WORKED EXAMPLE	A model, diagram or calculation worked through step by step.
COMMON MISTAKE	An error that commonly costs marks — check yourself against it.
EXAM TIP	How to turn the knowledge into marks in an exam response.
BRETTONOMICS INTERACTIVE	A matching interactive tool on brettonomics.com.

SECTION 1 Key concepts and terminology

Term	What it means
Market concentration	The extent to which a small number of firms account for a large share of total output or sales in a market.
Market power	The ability of a firm to influence the price of its product rather than accept the market price.
Concentration ratio	The combined market share of the largest firms, e.g. CR4 is the share held by the four largest firms.
Barriers to entry	Obstacles preventing new firms entering a market, such as high capital costs, established brands, patents or control of distribution.
Anticompetitive behaviour	Conduct that substantially lessens competition, such as cartel conduct, misuse of market power or exclusive dealing.
Natural monopoly	A market where a single firm can supply the whole market at lower average cost than two or more firms, because of very large economies of scale.

IN ONE SENTENCE Concentration describes the structure of a market; market power describes what firms can do with it.

SECTION 2 Concentration, market power and the three efficiencies

2.1 Allocative efficiency

- A competitive firm prices at marginal cost, so the value of the last unit equals the cost of producing it.
- A firm with market power restricts output and prices above marginal cost, so some consumers who value the good above its cost of production do not buy it.
- The result is allocative inefficiency and a deadweight loss — the standard efficiency case against concentration.

2.2 Productive efficiency

- Large firms may achieve genuine economies of scale, lowering average cost and improving productive efficiency.
- But a firm insulated from competition may also tolerate waste, because survival does not depend on minimising cost. This is sometimes called X-inefficiency.
- So concentration can cut either way on productive efficiency, which is why the evidence matters more than the theory.

2.3 Dynamic efficiency

KEY DEFINITION

Concentration and innovation — both directions

The case against concentration. A protected firm faces little pressure to innovate, so product and process improvement slows.

The case for concentration. Large firms have the retained profits and scale to fund research and development, and patent protection gives them a reason to invest in it.

The resolution. Some market power can support innovation, but entrenched power without the threat of entry tends to suppress it. Judge each market on its evidence.

COMMON MISTAKE

Concentration is not automatically harmful. A concentrated market can deliver lower prices through scale. The economic objection is to market power being used to restrict output or exclude rivals — not to firm size itself. Strong answers make that distinction.

IN ONE SENTENCE Concentration harms allocative efficiency most clearly; its effect on productive and dynamic efficiency is genuinely ambiguous.

SECTION 3 How market concentration changes over time

3.1 Movement along the spectrum

- Markets shift between perfect competition, monopolistic competition, oligopoly and monopoly as conditions change.
- **Forces increasing concentration:** mergers and acquisitions, economies of scale, network effects, control of key inputs or distribution, and regulatory barriers.
- **Forces reducing concentration:** new technology lowering entry costs, deregulation, import competition, and digital platforms reducing search costs.

3.2 Network effects and digital markets

- A network effect exists when a product becomes more valuable as more people use it, so an early lead can become self-reinforcing.
- This explains why some digital markets tip toward one or two dominant firms despite low production costs.

AUSTRALIAN CONTEXT

Australian retail grocery. Two chains account for roughly two-thirds of the grocery market between them, one of the more concentrated grocery sectors in the developed world.

Banking. The four major banks dominate deposits and home lending, a structure reinforced by the historical "four pillars" policy.

Fuel and aviation. Fuel refining and retailing are concentrated, and domestic aviation operates effectively as a duopoly.

Why Australia. A population of about 28 million spread over a continent means efficient scale is often reached with very few firms.

IN ONE SENTENCE Concentration is not fixed — identify the force that is changing it in the market you are analysing.

SECTION 4 Private and social costs and benefits of concentration

4.1 Costs

- Higher prices and reduced output relative to the competitive benchmark, producing a deadweight loss.
- A transfer of surplus from consumers to producers, which is a distributional as well as an efficiency concern.
- Reduced choice, and weaker incentives to improve quality or service.
- Possible under-provision in less profitable segments, such as regional and remote areas.

4.2 Benefits

- Economies of scale that genuinely lower average costs and can be passed to consumers.
- Capacity to fund research, development and large capital investment.
- Stability and the ability to absorb shocks, which matters in sectors such as banking.

4.3 Reading the diagram

WORKED EXAMPLE

Showing the welfare effect of market power

1. Set the competitive benchmark. Draw demand and marginal cost; the competitive outcome is where price equals marginal cost, giving Qc.

2. Add the firm with market power. A price-setting firm produces where marginal revenue equals marginal cost, giving a lower quantity Qm.

3. Read the price. Price is taken from the demand curve above Qm, so Pm exceeds marginal cost.

4. Identify the transfer. The rectangle between Pm and the competitive price, across Qm, is surplus transferred from consumers to the firm.

5. Shade the deadweight loss. The triangle between Qm and Qc, bounded by demand and marginal cost, is the welfare lost because mutually beneficial trades do not occur.

6. Conclude. Output is restricted below the allocatively efficient level, so resources are under-allocated to this good.

IN ONE SENTENCE The efficiency cost of market power is the restricted output, not the high price in itself.

SECTION 5 The ACCC and the courts

5.1 What the ACCC does

- The Australian Competition and Consumer Commission administers the Competition and Consumer Act 2010.
- **Prohibited conduct includes:** cartel conduct (price fixing, market sharing, bid rigging), misuse of market power, anticompetitive agreements, exclusive dealing, and misleading or deceptive conduct.
- The ACCC investigates, accepts undertakings, and brings proceedings; the courts impose penalties and make binding orders.
- It also conducts public inquiries into particular sectors, which inform policy even where no breach is found.

5.2 Merger control

AUSTRALIAN CONTEXT

A major change, in force since 1 January 2026. Australia moved from a voluntary, court-enforced merger system to a mandatory and suspensory regime. Acquisitions above the thresholds must be notified to the ACCC and cannot complete until the ACCC approves them or grants a waiver.

The thresholds. Notification is required where the merged firm's combined Australian revenue is at least $200 million and either the target's Australian revenue is at least $50 million or the global transaction value is at least $250 million. A lower bar applies to very large acquirers: Australian revenue of at least $500 million acquiring a target with at least $10 million. Further asset-based thresholds commenced on 1 April 2026.

Why the change matters for evaluation. Under the old regime the ACCC had to persuade a court to stop a merger after the fact. It now decides first, which shifts the burden of proof onto the merging parties and is intended to catch the creeping acquisitions that gradually concentrated sectors such as groceries and health care.

Why it matters economically. Under the old system the ACCC had to persuade a court to block or unwind a deal after the fact. The new administrative model shifts the decision to before the merger occurs, which is a far stronger check on increasing concentration.

The limit. Deals below the thresholds can still be investigated, but are not caught automatically.

EXAM TIP

Name the test. The legal standard is whether an acquisition or conduct would have the effect, or likely effect, of substantially lessening competition. Using that phrase shows you understand the actual framework rather than a general dislike of big firms.

IN ONE SENTENCE Competition policy targets conduct and structural change that substantially lessens competition.

SECTION 6 Government strategies to increase competition

6.1 The main instruments

- **Structural measures:** blocking or conditioning mergers, and in rare cases requiring divestiture.
- **Conduct regulation:** prohibiting cartel conduct and misuse of market power, with substantial penalties.
- **Transparency:** price monitoring and mandatory disclosure, which reduce information asymmetry and support consumer switching.
- **Lowering entry barriers:** removing licensing and planning barriers, and mandating access to essential infrastructure.
- **Consumer measures:** reducing switching costs, for example through data portability and consumer data rights.

6.2 Different perspectives

- **Consumers:** lower prices, more choice, and better service.
- **Incumbent firms:** compliance costs, and the argument that scale is necessary to compete internationally.
- **New entrants and suppliers:** access to markets and to essential infrastructure on fair terms.
- **Workers and regions:** employment and investment in concentrated industries.

COMMON MISTAKE

Intervention is not costless. Competition policy has administrative cost, can be slow, and risks regulatory capture. A strong evaluation weighs the size of the competition problem against the cost and reliability of the remedy rather than assuming intervention always improves outcomes.

IN ONE SENTENCE Judge a competition policy by whether it lowers barriers and restores rivalry, not by whether it punishes large firms.

SECTION 7 Working with the evidence

7.1 Measuring concentration

- Concentration ratios such as CR4 are simple but ignore the distribution of share among the leading firms.
- The Herfindahl–Hirschman Index squares each firm's share and sums them, so it weights dominance more heavily.
- Both depend entirely on how the market is defined: a national grocery share and a single-town grocery share tell different stories.

EXAM TIP

Interrogate the source. The syllabus asks you to appreciate underlying assumptions and perspectives. Ask who produced the figure, how they defined the market, what period it covers, and what interest they have in the answer. An industry body and a consumer group can both be accurate and still disagree.

IN ONE SENTENCE A concentration statistic is only as meaningful as the market definition behind it.

ASSESSMENT Multiple choice questions

20 questions covering Unit 2 Topic 2 Case option A. Answers and explanations follow the question set.

Question 1

Market concentration refers to:

A. The ability of a single firm to set its own price
B. The total number of consumers in a market
C. The extent to which a small number of firms account for a large share of a market
D. The share of national income earned by the largest industries

Question 2

The clearest efficiency objection to market power is that the firm:

A. Restricts output and prices above marginal cost, creating a deadweight loss
B. Earns higher profits than firms in competitive markets
C. Produces at the lowest point on its average cost curve
D. Invests too heavily in research and development

Question 3

Which is a legitimate efficiency argument in favour of large firms?

A. They always price at marginal cost
B. They eliminate the need for competition regulation
C. They guarantee allocative efficiency
D. They may achieve economies of scale that lower average costs

Question 4

X-inefficiency in a concentrated market refers to:

A. A firm producing where marginal revenue equals marginal cost
B. A firm tolerating avoidable costs because weak competition does not force it to minimise them
C. The deadweight loss triangle on a monopoly diagram
D. The transfer of surplus from consumers to producers

Question 5

A network effect exists when:

A. A product becomes more valuable to each user as the number of users increases
B. A firm operates across several countries
C. Average costs fall as output rises
D. Two firms agree to divide a market between them

Question 6

Which combination best explains why many Australian markets are oligopolistic?

A. Australian law requiring a minimum firm size
B. A lack of consumer demand for competition
C. The absence of any competition regulator
D. A relatively small population over a large area, combined with scale economies and high capital requirements

Question 7

On a diagram, the deadweight loss from market power is:

A. The rectangle showing surplus transferred from consumers to the firm
B. The triangle between the monopoly and competitive quantities, bounded by demand and marginal cost
C. The firm's total economic profit
D. The area under the marginal revenue curve

Question 8

The legal test applied under Australian competition law is whether conduct or an acquisition:

A. Increases the profits of the firm involved
B. Results in any increase in market concentration
C. Has the effect, or likely effect, of substantially lessening competition
D. Reduces the number of firms in the market below four

Question 9

Cartel conduct includes all of the following EXCEPT:

A. Investing in new production technology to lower costs
B. Agreeing with a competitor to fix prices
C. Agreeing with a competitor to share markets
D. Agreeing with a competitor to rig bids

Question 10

From 1 January 2026, Australia's merger regime requires that:

A. All mergers be approved by a court before completion
B. Firms notify the ACCC only if they choose to
C. Mergers in concentrated industries be automatically prohibited
D. Acquisitions above set thresholds be notified to the ACCC and not proceed until approved

Question 11

The main economic advantage of the new merger regime over the previous one is that:

A. It guarantees no merger will ever be approved
B. Competition concerns are assessed before a merger proceeds rather than litigated afterwards
C. It removes the ACCC's role in competition enforcement
D. It replaces the substantial lessening of competition test

Question 12

A concentration ratio such as CR4 is limited because it:

A. Cannot be calculated for Australian industries
B. Measures profitability rather than market share
C. Ignores how market share is distributed among the leading firms and depends on market definition
D. Applies only to monopoly markets

Question 13

When evaluating evidence of market concentration, the syllabus asks students to:

A. Accept figures published by industry bodies without question
B. Use only data that supports government intervention
C. Avoid using statistics altogether in extended responses
D. Examine the underlying assumptions and perspectives of the source

Question 14

Which measure most directly lowers barriers to entry?

A. Mandating access to essential infrastructure on regulated terms
B. Increasing penalties for misleading advertising
C. Publishing average retail prices each quarter
D. Requiring firms to report their profits publicly

Question 15

Under-provision of services in regional and remote areas by concentrated firms is best described as:

A. A benefit of economies of scale
B. A social cost of concentration, because profitable segments are served and others are not
C. Evidence of allocative efficiency
D. An example of a network effect

Question 16

Competitive pressure is generally argued to improve dynamic efficiency because firms:

A. Can fund research only when they hold monopoly profits
B. Always price above marginal cost
C. Must innovate and invest to retain customers and margins
D. Face lower average costs as they grow

Question 17

Divestiture as a competition remedy means:

A. Requiring a firm to sell part of its business to reduce its market power
B. Prohibiting a firm from advertising its prices
C. Taxing a firm's economic profits
D. Requiring a firm to publish its costs

Question 18

A natural monopoly exists where:

A. A firm has obtained a patent over its product

B. Only one firm has chosen to enter the market

C. A government has nationalised an industry

D. A single firm can supply the entire market at lower average cost than two or more firms could

Question 19

A key risk of competition regulation itself is:

A. That it always reduces firm profits to zero

B. That it guarantees perfect competition

C. Regulatory capture, where the regulator comes to reflect the interests of the firms it oversees

D. That it eliminates economies of scale

Question 20

Which statement best reflects a balanced evaluation of market concentration?

A. Concentration is always harmful and should be prohibited

B. Concentration harms allocative efficiency most clearly, while its effects on productive and dynamic efficiency depend on the market

C. Concentration is always beneficial because it delivers scale economies

D. Concentration has no measurable effect on economic efficiency

ASSESSMENT Marking guide

Answer key

Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10
C	A	D	B	A	D	B	C	A	D
Q11	**Q12**	**Q13**	**Q14**	**Q15**	**Q16**	**Q17**	**Q18**	**Q19**	**Q20**
B	C	D	A	B	C	A	D	C	B

Explanations

Q1 C Concentration describes market structure. The ability to set price is market power, which concentration tends to confer.

Q2 A The welfare cost is the restricted output. High profit alone is a distributional issue, not an efficiency loss.

Q3 D Scale economies are a genuine productive-efficiency benefit, which is why concentration is not automatically harmful.

Q4 B X-inefficiency is organisational slack arising from the absence of competitive pressure.

Q5 A Network effects can cause markets to tip toward one or two firms, because an early lead becomes self-reinforcing.

Q6 D Efficient scale is reached with few firms in a market of Australia's size, and entry costs are high in infrastructure-heavy sectors.

Q7 B The transfer rectangle is a distributional effect; only the triangle measures welfare genuinely lost.

Q8 C Substantially lessening competition is the statutory test; concentration rising is relevant evidence but not the test itself.

Q9 A Price fixing, market sharing and bid rigging are cartel conduct. Cost-reducing investment is ordinary competitive behaviour.

Q10 D The new regime is mandatory and suspensory, replacing the previous voluntary, court-enforced system.

Q11 B Pre-approval is a stronger check than having to unwind a completed acquisition through the courts.

Q12 C CR4 treats four equal firms and one dominant firm plus three small ones identically. The HHI addresses this by squaring shares.

Q13 D Market definition, period and the producer's interest all shape a concentration figure, so the source must be interrogated.

Q14 A Access regimes let new entrants use infrastructure they could not economically duplicate. The other measures improve transparency or conduct, not entry.

Q15 B Where thin markets are unprofitable, concentration can leave them under-served — a distributional and social cost.

Q16 **C** The threat of losing customers drives innovation. The counter-argument — that scale funds research — is why the net effect must be judged case by case.

Q17 **A** Divestiture is a structural remedy that changes the market's composition rather than regulating conduct within it.

Q18 **D** Very large economies of scale relative to market size make duplication wasteful, which is typical of pipelines, grids and rail networks.

Q19 **C** Capture, administrative cost and slow decisions are the standard government-failure risks in competition policy.

Q20 **B** The allocative cost is robust; the productive and dynamic effects cut both ways, so the evidence for the particular market decides.