## What Is a Monopoly?

A monopoly refers to when a company and its product offerings dominate a sector or industry. The term monopoly is often used to describe an entity that has total or near-total control of a market.

Monopolies can result from extreme free-market [capitalism](https://www.investopedia.com/terms/f/freemarket.asp); in that absent any restriction or restraints, a single company or group becomes large enough to own all or nearly all of the market (including by acquiring competitors) for a particular type of product or service.

On the other hand, monopolies can also arise and be sustained by government-enforced [barriers to entry](https://www.investopedia.com/terms/b/barrierstoentry.asp) or regulations that limit competition (e.g., in the case of utilities).

### **KEY TAKEAWAYS**

* A monopoly refers to when a company and its product offerings dominate one sector or industry.
* Monopolies can be considered an extreme result of free-market capitalism and are often used to describe an entity that has total or near-total control of a market.
* Natural monopolies can exist when there are high barriers to entry; a company has a patent on their products, or is allowed by governments to provide essential services.

#### **What's a Monopoly?**

## Understanding Monopoly

A monopoly is characterized by the absence of competition, which can lead to high costs for consumers, inferior products and services, and corrupt behavior. A company that dominates a business sector or industry can use that dominance to its advantage, and at the expense of others. It can create artificial scarcities, [fix prices](https://www.investopedia.com/terms/p/pricefixing.asp), and circumvent natural [laws of supply and demand](https://www.investopedia.com/terms/l/law-of-supply-demand.asp). It can impede new entrants into the field, discriminate and inhibit experimentation or new product development, while the public—robbed of the recourse of using a competitor—is at its mercy. A monopolized market often becomes unfair, unequal, and inefficient.

Mergers and acquisitions among companies in the same business are highly regulated and researched for this reason. Firms are typically forced to divest assets if federal authorities believe a proposed merger or takeover will violate anti-monopoly laws. By divesting assets, it allows competitors to enter the market by those assets, which can include plant and equipment and customers.

Monopolies typically have an unfair advantage over their competition since they are either the only provider of a product or control most of the market share or customers for their product. Although monopolies might differ from industry to industry, they tend to share similar characteristics that include:

* **High barriers of entry**: Competitors are not able to enter the market, and the monopoly can easily prevent competition from developing their foothold in an industry by acquiring the competition.
* **Single seller**: There is only one seller in the market, meaning the company becomes the same as the industry it serves.
* **Price maker**: The company that operates the monopoly decides the price of the product that it will sell without any competition keeping their prices in check. As a result, monopolies can raise prices at will.
* **Economies of scale:** A monopoly often can produce at a lower cost than smaller companies. Monopolies can buy huge quantities of inventory, for example, usually a volume discount. As a result, a monopoly can lower its prices so much that smaller competitors can't survive. Essentially, monopolies can engage in price wars due to their scale of their manufacturing and distribution networks such as warehousing and shipping, which can be done at lower costs than any of the competitors in the industry.

A company with a pure monopoly means that a company is the only seller in a market with no other close substitutes. For many years, Microsoft Corporation had a monopoly on the software and operating systems that are used in computers. Also, with pure monopolies, there are high barriers to entry, such as significant start-up costs preventing competitors from entering the market. ([What's the Difference Between Monopoly and an Oligopoly](https://www.investopedia.com/ask/answers/121514/what-are-major-differences-between-monopoly-and-oligopoly.asp)? Learn more.)

When there are multiple sellers in an industry with many similar substitutes for the goods being produced and companies retain some power in the market, it's referred to as [monopolistic competition](https://www.investopedia.com/terms/m/monopolisticmarket.asp). In this scenario, an industry has many businesses that offer similar products or services, but their offerings are not perfect substitutes. In some cases, this can lead to [duopolies](https://www.investopedia.com/terms/d/duopoly.asp).

In a monopolistic competitive industry, barriers to entry and exit are typically low, and companies try to differentiate themselves through price cuts and marketing efforts. However, since the products offered are so similar between the different competitors, it's difficult for consumers to tell which product is better. Some examples of monopolistic competition include retail stores, restaurants, and hair salons.

## Natural Monopoly

A [natural monopoly](https://www.investopedia.com/terms/n/natural_monopoly.asp) can develop when a company becomes a monopoly due to high fixed or start-up costs in an industry. Also, natural monopolies can arise in industries that require unique raw materials, technology, or it's a specialized industry where only one company can meet the needs.

Companies that have [patents](https://www.investopedia.com/terms/p/patent.asp) on their products, which prevents competition from developing the same product in a specific field can have a natural monopoly. Patents allow the company to earn a profit for several years without fear of competition to help recoup the investment, high start-up, and research and development (R&D) costs that the company incurred. Pharmaceutical or drug companies are often allowed patents and a natural monopoly to promote innovation and research.

There are also public monopolies set up by governments to provide essential services and goods, such as the U.S. Postal Service (though of course, the USPS has less of a monopoly on mail delivery since the advent of private carriers like United Parcel Service and FedEx).

The [utilities industry](https://www.investopedia.com/articles/investing/022516/worlds-top-10-utility-companies.asp) is where natural or government-allowed monopolies flourish. Usually, there is only one major (private) company supplying energy or water in a region or municipality. The monopoly is allowed because these suppliers incur large costs in producing power or water and providing these essentials to each local household and business, and it is considered more efficient for there to be a sole provider of these services.

Imagine what a neighborhood would look like if there were more than one electric company serving an area. The streets would be overrun with utility poles and electrical wires as the different companies compete to sign up customers, hooking up their power lines to houses. Although natural monopolies are allowed in the utility industry, the tradeoff is that the government heavily regulates and monitors these companies. Regulations can control the rates that utilities charge its customers, and the [timing of any rate increases](https://www.investopedia.com/ask/answers/040915/what-are-characteristics-monopolistic-market.asp).

## Antitrust Laws

Antitrust laws and regulations are put in place to discourage monopolistic operations— protecting consumers, prohibiting practices that restrain trade, and ensuring a marketplace remains open and competitive.

In 1890, the [Sherman Antitrust Act](https://www.investopedia.com/terms/s/sherman-antiturst-act.asp)became the first legislation passed by the U.S. Congress to limit monopolies. The Sherman Antitrust Act had strong support by Congress, passing the Senate with a vote of 51 to 1 and passing the House of Representatives unanimously 242 to 0.1﻿

In 1914, two additional antitrust pieces of legislation were passed to help protect consumers and prevent monopolies. The [Clayton Antitrust Act](https://www.investopedia.com/terms/c/clayton-antitrust-act.asp)created new rules for mergers and corporate directors, and also listed specific examples of practices that would violate the Sherman Act. The Federal Trade Commission Act created the [Federal Trade Commission](https://www.investopedia.com/terms/f/ftc.asp) (FTC), which sets standards for business practices and enforces the two antitrust acts, along with the Antitrust Division of the United States Department of Justice.2﻿

The laws are intended to preserve competition and allow smaller companies to enter a market, and not to merely suppress strong companies.

## Breaking up Monopolies

The Sherman Antitrust Act has been used to break up large companies over the years, including Standard Oil Company and American Tobacco Company.

In 1994, the U.S. government accused Microsoft of using its significant [market share](https://www.investopedia.com/terms/m/marketshare.asp) in the PC operating systems business to prevent competition and maintain a monopoly. The complaint, filed on July 15, 1994, stated:

The United States of America, acting under the direction of the Attorney General of the United States, brings this civil action to prevent and restrain the defendant Microsoft Corporation from using exclusionary and anticompetitive contracts to market its personal computer operating system software. By these contracts, Microsoft has unlawfully maintained its monopoly of personal computer operating systems and has an unreasonably restrained trade. *3*

A federal district judge ruled in 1998 that Microsoft was to be broken into two technology companies, but the decision was later reversed on appeal by a higher court. The controversial outcome was that, despite a few changes, Microsoft was free to maintain its operating system, application development, and marketing methods.4

The most prominent monopoly breakup in U.S. history was that of AT&T. After being allowed to control the nation's telephone service for decades, as a government-supported monopoly, the giant telecommunications company found itself challenged under antitrust laws. In 1982, after an eight-year court battle, AT&T had to divest itself of 22 local exchange service companies, and it has been forced to sell off assets or split units several times since.5

### **What Are Some Common Characteristics of Monopolies?**

Although monopolies might differ from industry to industry, they share similar characteristics. There are high barriers of entry where competitors are not able to enter the market. There is only one seller in the market, meaning the company becomes the same as the industry it serves. The company that operates the monopoly decides the price of the product that it will sell without any competition keeping their prices in check which means that they can raise prices at will. Finally, monopolies have economies of scale which allows them to lower prices to levels that smaller competitors can't survive.

### **What Is a Natural Monopoly?**

Typically, a natural monopoly exists due to the high start-up costs or powerful economies of scale of conducting a business in a specific industry which can result in significant barriers to entry for potential competitors. A company with a natural monopoly might be the only provider of a product or service in an industry or geographic location. Natural monopolies can arise in industries that require unique raw materials, technology, or similar factors to operate. Natural monopolies can also arise when one firm is much more efficient than multiple firms in providing the good or service to the market.

### **Why Are Monopolies Unfair?**

A monopoly is characterized by the absence of competition, which can lead to high costs for consumers, inferior products and services, and corrupt behavior. A company that dominates a business sector or industry can use that dominance to its advantage, and at the expense of others. It can create artificial scarcities, fix prices, and circumvent natural laws of supply and demand. It can impede new entrants into the field, discriminate and inhibit experimentation or new product development, while the public—robbed of the recourse of using a competitor—is at its mercy.

### **What Antitrust Laws Exist to Breakup Monopolies?**

Antitrust laws and regulations are put in place to discourage monopolistic operations—protecting consumers, prohibiting practices that restrain trade, and ensuring a marketplace remains open and competitive. In 1890, the Sherman Antitrust Act became the first legislation passed by the U.S. Congress to limit monopolies. In 1914, two additional antitrust pieces of legislation were passed to help protect consumers and prevent monopolies.

The Clayton Antitrust Act created new rules for mergers and corporate directors, and also listed specific examples of practices that would violate the Sherman Act. The Federal Trade Commission Act created the Federal Trade Commission (FTC), which sets standards for business practices and enforces the two antitrust acts, along with the Antitrust Division of the United States Department of Justice.