**Price Leadership Model**

Price leadership is an important form of collusive oligopoly. Under it, one firm sets the price, others follow it. Price leadership also comes into existence either through tacit or formal agreement. But as the formal or open agreement to establish price leadership is generally illegal, price leadership is generally established as a result of informal and tacit understanding between the oligopolists. The competing oligopolists in an informal meeting choose a leader and agree to follow him in setting price.

**Types of Price Leadership:**

Price leadership is of various types.

1. Firstly, there ***is a price leadership by a low-cost firm***. In order to maximise profits the low-cost firm sets a lower price than the profit-maximizing price of the high-cost firms. Since the high-cost firms will not be able to sell their product at the higher price, they are forced to agree to the low price set by the low-cost firm. Of course, the low-cost price leader has to ensure that the price which he sets must yields some profits to the high-cost firms—their follow­ers.
2. Secondly, ***there is a price leadership of the dominant firm***. Under this one of the few firms in the industry may be producing a very large proportion of the total production of the industry and may therefore dominate the market for the product. This dominant firm wields a great influence over the market for the product, while other firms are small and are incapable of making any impact on the market. As a result, the dominant firm estimates its own demand curve and fixes a price which maximises its own profits. The other firms which are small having no individual effects on the price, of the product, follow the dominant firm and accepting the price set by it and adjusts their output accordingly.
3. Thirdly, ***there is a barometric price leadership*** under which an old, experienced, largest or most respected firm assumes the role of a custodian who protects the interests of all. He assesses the change in the market conditions with regard to the demand for the product, cost of production, competition from the related products etc. and makes changes in price which are best from the viewpoint of all the firms in the industry. Naturally, other firms follow him willingly.
4. Fourthly, ***there is exploitative or aggressive price leadership*** under which a very large or dominant firm establishes its leadership by following aggressive price policies and thus compels the other firms in the industry to follow him in respect of price. Such a firm will often initiate a move threatening to compete the others out of market if they do not follow him in setting their prices.

**Difficulties of Price Leadership:**

Price leadership involves many difficulties in the real world. Some of them can be discussed below:

1. First, the success of price leader­ship of a firm depends upon the correctness of his estimates about the reactions of his followers. If his estimates about the reactions of his rivals to price changes by it prove to be incorrect, then not only the success of his price policy but also his leadership in the market will be jeopardized.
2. Sec­ondly, when a price leader fixes a higher price than the followers would prefer, there is a strong tendency for the followers to make hidden price cuts in order to increase their shares of the market without openly challenging the price leader. A good number of devices which amount to secret price cutting are used by business firms. Some of these secret price-cutting devices are the offer of rebates, favorable credit terms, ‘money back’ guarantees, after-delivery free services, sale on the payment of price in easy installments with low rates of interest etc., and liberal entertainment of the buyers.
3. Price leaders are generally fed up with the increasing number of concessions granted by their rivals and they make an open price cut to prevent further fall in their share of the market. In such circumstances price leadership becomes unproductive.
4. Another important difficulty of maintaining price leadership is the tendency on the part of the rivals to indulge in non-price competition to increase sales while go on charging the price set by the price leader. The devices used under ‘non-price competition’ include advertising and other methods of the sales promotion, like improvement of the quality of the product, in addition to the hidden price- product concessions mentioned above.
5. Further, there is a great limitation on the price leader to fix a high price of his product. This is because the high price will induce the rivals to make secret price cuts which will adversely affect the sales of the price leader. Moreover, a high price fixed by the price leader will attract new competitors into the industry which may not accept his leadership.
6. Lastly, differences in costs also pose a problem. If the price leader has higher costs, then the high price fixed by him will, as mentioned above, induce the rivals to undercut price or will attract the entry of new firms into the industry. If the price leader has lower costs than his rivals, he will set a low price which will antagonize his rivals who will disturb him quite frequently.