Monopolistic Competition


重庆酸辣粉


正宗
BT
烤
翅
鱿鱼大王


编号：20121029155809727200 上传者：peak


奈雪の茶

Characteristics of monopolistic competition

1. Large number of firms.
2. No/low barriers to entry and exit
3. **Product differentiation**

Monopolistic competition

In real world, most markets lie between the extremes of perfect competition and monopoly.

Most of them obtained some **power to set their product price** as the monopolist do, and they face **competition** by entry of new firms as the firms in perfect competition do.

A given monopolistically competitive firm has a **little bit of control** over its **small corner of the market**.

Market structure	No. of firms	Product differentiation	Barriers to entry	Market power	Degree of competition	Examples
Perfect competition	Large no. of small firms	Homogeneous products (identical, no brand names)	No barriers to entry	None	Perfect	Agriculture, silver and gold, stock and bond, foreign exchange market
Monopolistic competition	Large No. of firms	Product differentiation	No barriers to entry	Some	A good amount	Shoe, clothing, computer, restaurant, novel
Oligopoly	Small no. of large firms	Differentiated or undifferentiated	High barriers to entry	Significant	Some	Coca-Cola & Pepsi, car industry, airlines Oil, steel, aluminum, copper
Monopoly	Single seller or dominant firm	Unique goods without close substitutes	High barriers to entry	Very significant	None	Electricity supply, water supply, train system in China. Microsoft operating system with windows

Shoe repairs and key makers

Taxi and minibus companies

Sandwich bars and coffee stores

Hairdressing salons

Dry-cleaners and launderettes

Bars and Nightclubs

Product differentiation

Product differentiation occurs when each firm in an industry tries to make its product different from those of its competitors.

1. **Physical differences**
   - Size, shape, materials, texture, taste, packaging, etc.
2. **Quality differences**
3. **Location**
   - Hotels near airport or scenic spot, Pinghe Café, etc.
4. **Service**
   - Home delivery, product demonstrations, free support, warranties, purchase terms
5. **Product image**
   - Create a favourable image by use of celebrity advertising or endorsements, brand names, attractive packaging, etc.

Product differentiation

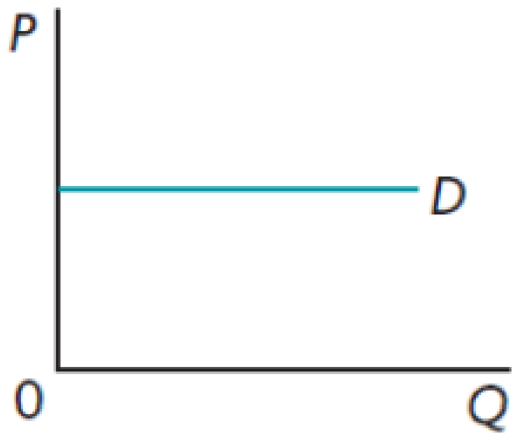
→Each firm in an industry is a **mini-monopoly** in the specific version of the good that it produces.

- If consumers can be convinced that the product they are purchasing is superior to the available substitutes, then it has succeed in establishing a mini-monopoly for its product.
- When price increase, those loyal consumers will continue to buy.

Demand curve for monopolistic competition

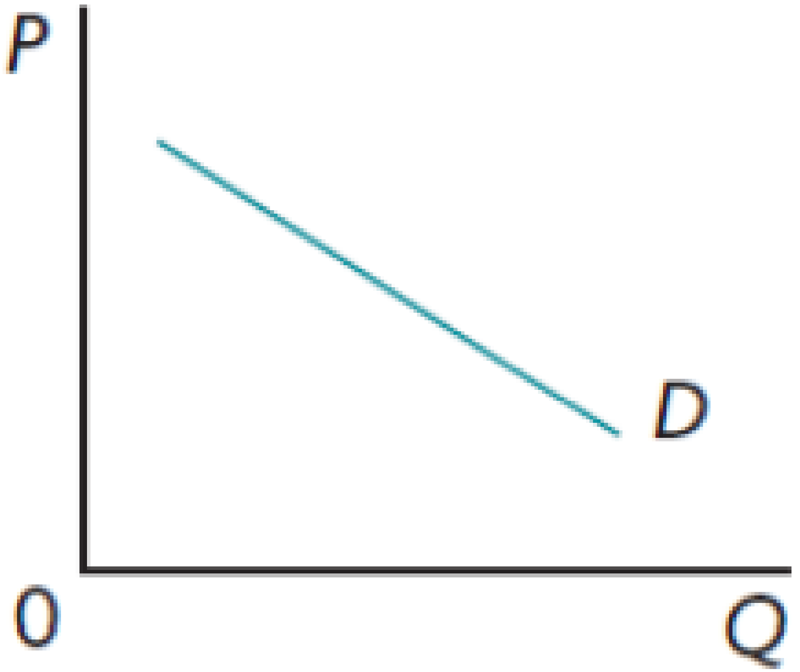
- Perfect elastic of demand curve

a Perfect competition



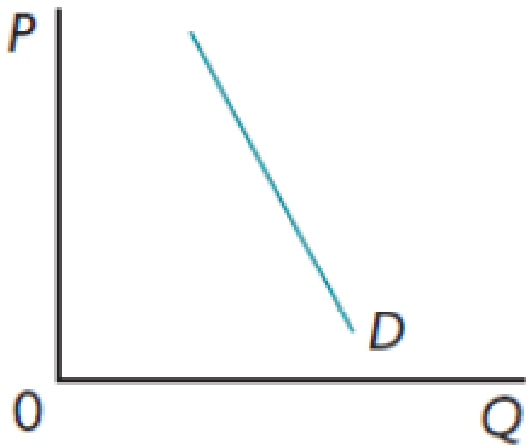
- **Due to large no. of substitutes, the demand curve is more elastic than monopoly and less elastic than perfect competition**

c Monopolistic competition



- Due to less no. of substitutes, relatively inelastic of demand curve

b Monopoly



Price and non-price competition

- **Price competition** occurs when a firm lowers its price to attract customers away from rival firms, thus increasing sales at the expense of other firms.
- Like a monopoly, the firm can set both its price and its output, but it faces trade-off between the product quality and price.
  - Higher quality → higher price
  - Lower quality → lower price

- **A major advantage of price competition is its flexibility**: Prices can be adjusted to compensate for an increase in the firm's operating costs, to offset changes in demand, or to counteract a competitor's pricing strategy.
- **A disadvantage of price competition is that competitors usually have price flexibility too and can quickly respond by lowering their prices**— potentially sparking a **price war**. Chronic price wars can reduce profits and weaken an organization. Chronic price wars can reduce profits and weaken an organization.

Price and non-price competition

- **Non-price competition** occurs when firms use methods other than price reductions to attract customers from rivals.
- The firm emphasizes distinctive product features, service, product quality, promotion, packaging, or other factors to distinguish its product from competing brands.
  - →Product differentiation (R&D in product development, physical &quality differentiation, etc.)
  - → Advertising
  - → Branding

It's possible to decrease the elasticity by convincing consumers that the product is superior to the available substitutes.

→The ultimate goal is to increase their **market power** and their ability to **charge a higher price** without risking loss of buyers to rival firms.

→**Less elastic of demand**

→**Profit maximization**

In non-price competition

- **A major advantage** of non-price competition is that a firm can **build customer loyalty toward its brand.** If customers prefer a brand because of non-price factors, it is more difficult for competitors to lure these customers away.
- For non-price competition to work, a company must be **able to distinguish its brand** through unique product features, higher product quality, promotion, packaging, or excellent customer service.
- **Buyers must view the non-price product features as important**, and the features must be difficult for competitors to imitate.
- Even when competing on a non-price basis, **marketers must remain aware of competitors' prices** and be prepared to price its brand near or slightly above that of competing brands.

- Although any company can use a **non-price competition** strategy, it is most common among **oligopolies** and **monopolistic competition,** because firms can be extremely competitive.

Example of non-price competition

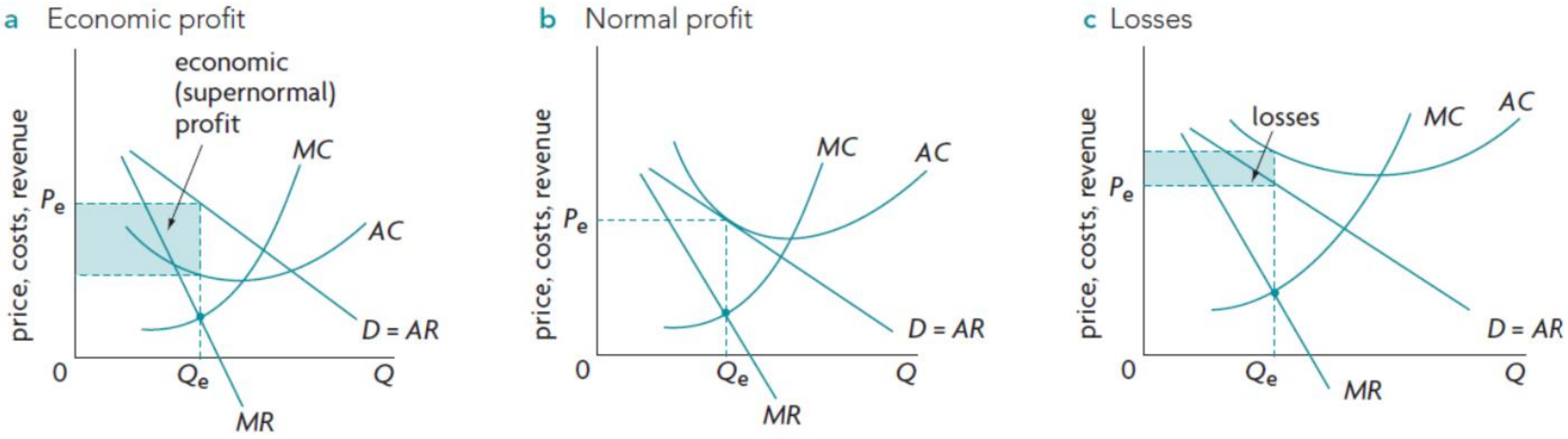
The **supermarket industry** is an **oligopoly market** in UK. The four major firms fierce compete over 75% of market share. The firms are **Morrison, ASDA, Sainsbury and Tesco**. where non-price competition has become important in the battle for sales:

- ✓ Traditional advertising / marketing
- ✓ Store Loyalty cards
- ✓ Banking and other Services (including travel insurance)
- ✓ In-store pharmacist and post offices
- ✓ Home delivery systems
- ✓ Discounted petrol at hypermarkets
- ✓ Extension of opening hours (24 hour shopping)
- ✓ Innovative use of technology for shoppers including self-scanning and internet shopping services

Profit-maximization in short-run

The short-run equilibrium position of the individual firm in monopolistic competition is identical to that of the monopolist.

Only difference: The demand curve is more elastic

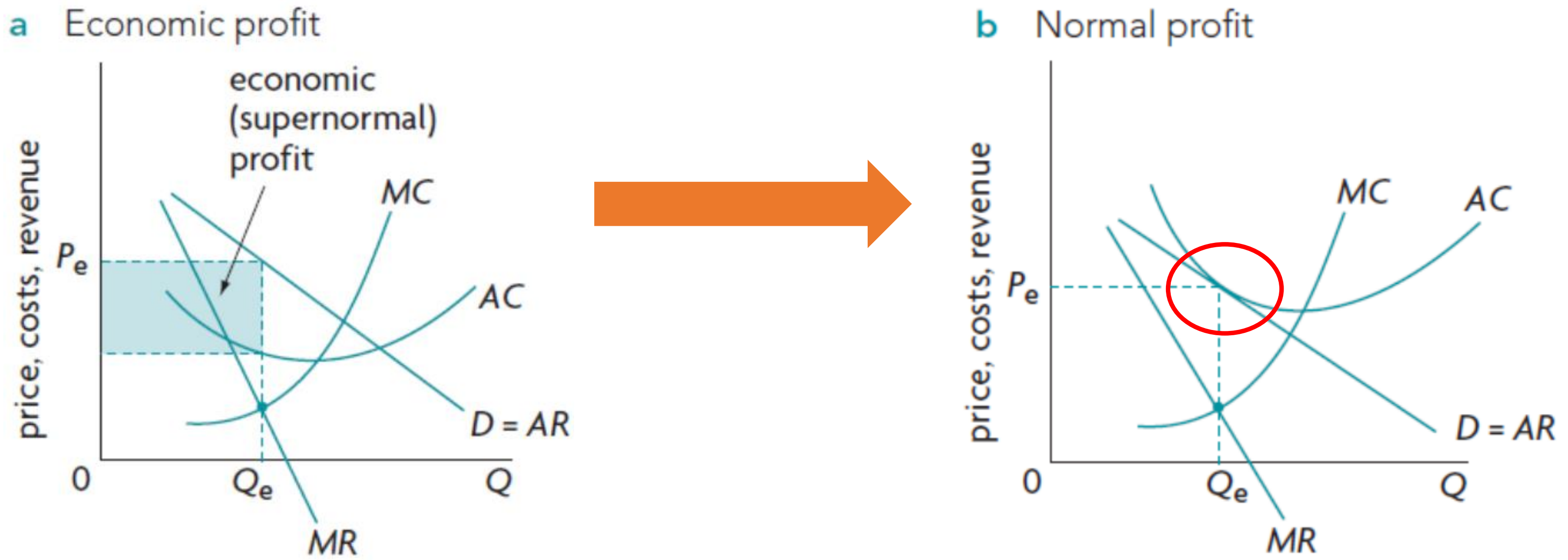


Normal profit in the long run

Long run in monopolistic competition:

- **For profit-making industries**:
  - New firms enter and attract customers away from existing firms.
  - The **demand curve of existing firms shift leftwards** until it tangent(touched) to the AC curve → normal profit. (**P=AC**)

*as in **perfect competition**, when new firms are attracted into the industry, the industrial **supply curve** shift rightwards and reduce the market price until it equals to minimal ATC (normal profit)



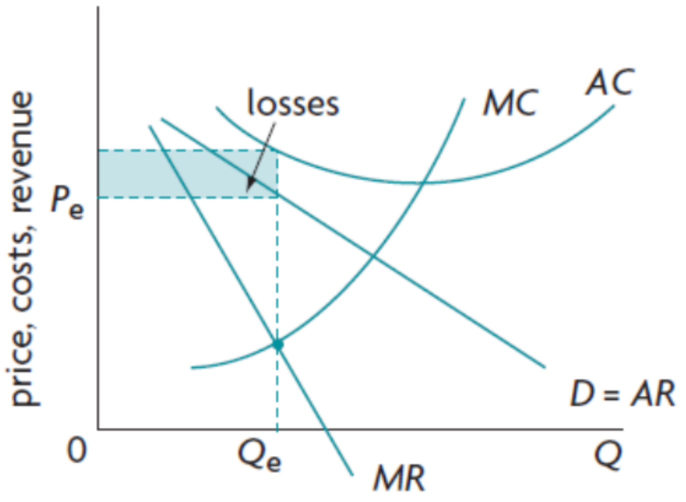
Normal profit in the long run

Long run in monopolistic competition:

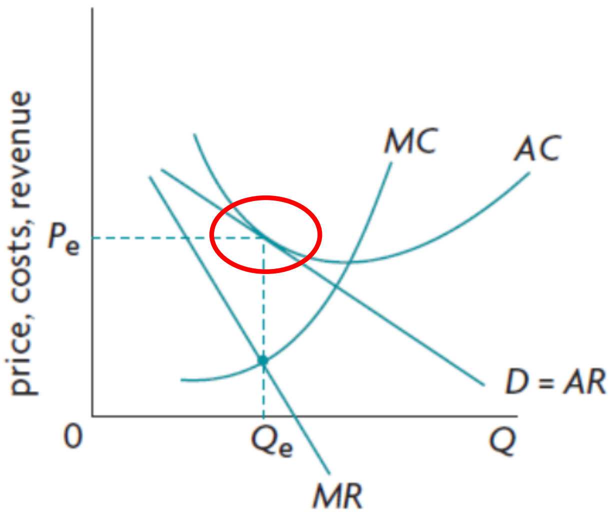
- **For** **Loss-making** **industries**:
  - Some firms shut down and exit the industry, their customers switch their purchasing to the remaining firms.
  - The **demand curve of remaining firms shift rightwards** until it tangent to the ATC curve, losses disappear.→ normal profit (**P=MC**)

*as in **perfect competition**, some firms would close down or switch to other industry, the industrial **supply curve** shift leftwards increase the market price until it equals to minimal ATC (normal profit)

c Losses



b Normal profit

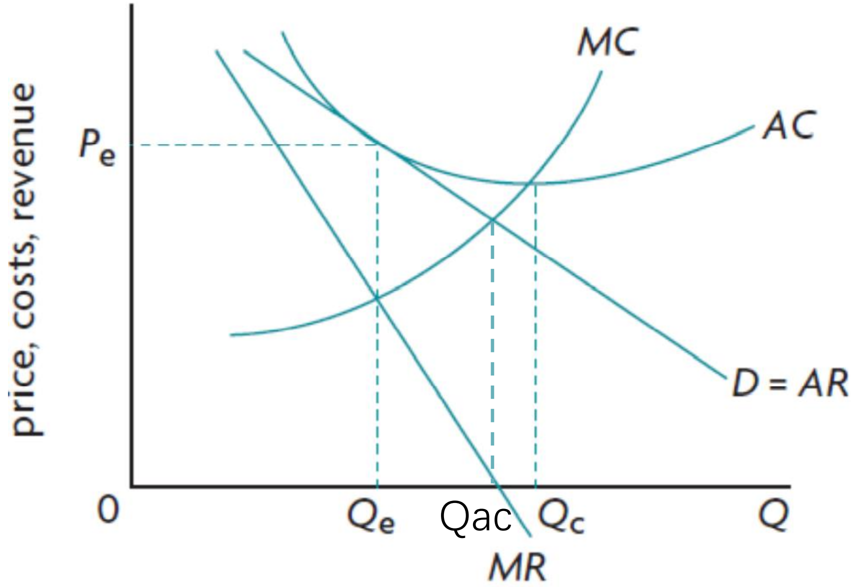


Allocative efficiency and market failure

When P=MC → allocative efficiency

- In the long-run equilibrium of the firm in monopolistic competition, the allocative efficiency is not achieved.
- At the equilibrium Q_e, P>MC → Market failure

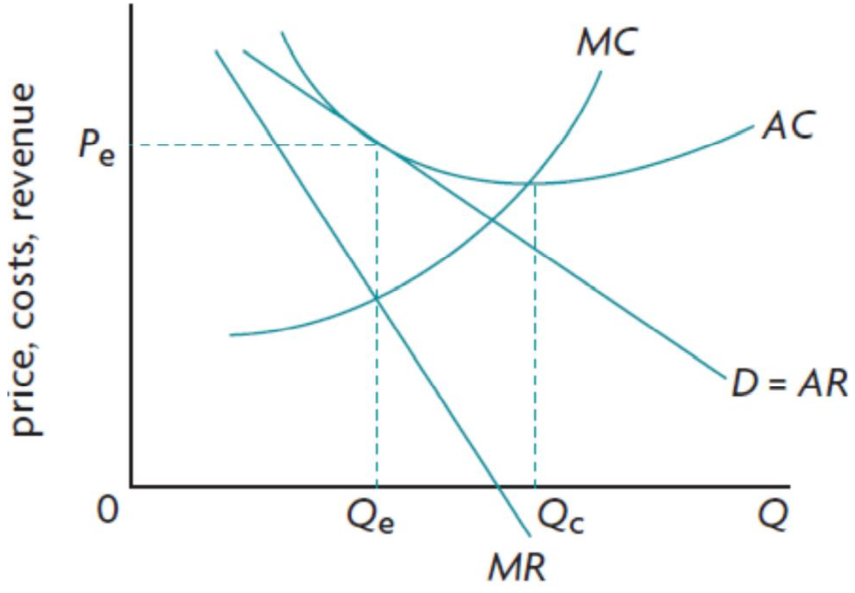
→ underallocation of resources $Q_e<Q_{ac}$, too little of the good is produced.



Productive Inefficiency and product differentiation

Productive efficiency: Production takes place at minimum ATC.

- For **monopolistic competition**, it is producing at profit maximizing level of output **Q_e <Q_c** (Productive efficiency level of output)



Comparison between Monopolistic competition and perfect competition

	Monopolistic Competition	Perfect Competition
Number of firms	Many	Infinite
Barriers to entry	None	None
Profit	Short-run: abnormal profit/loss Long run: normal profit	Short-run: abnormal profit/loss Long run: normal profit
Market power	Some, price maker	None, price taker
Demand curve	Relative elastic (downward-sloping)	Perfect elastic (horizontal)
Product variety	Yes	No
Allocative efficiency	Allocative inefficiency in SR &LR (P>MC)	Allocative efficiency in SR & LR (P=MC)
Productive efficiency	No	Yes
Market failure	Yes	No
Economies of scale	Small amount	No

Comparison between Monopolistic competition and Monopoly

	Monopolistic Competition	Monopoly
Number of firms	Many	Single
Size of firms	Small/Medium	Very large
Barriers to entry	None	High
Profit	Normal profit in long-run	abnormal profit
Market power	Low, price maker	High, price maker
Demand curve	Relative elastic (downward-sloping)	Relative inelastic (downward-sloping)
Competition and price	Lower price with larger quantity	Higher price with smaller quantity
Competition and cost	Downward pressure on cost	No downward pressure on cost
R&D	Do R&D due to competition	Do R&D due to abnormal profit and keep monopoly position
Product variety	high	Some
Economies of scale	Small amount	Large