

Lesson 3: Market Structure 3: Monopolistic Competition

MONOPOLISTIC COMPETITION

Characteristics:

- There are a large number of buyers and sellers.
- The products offered by each seller are similar, but not identical. They serve as close substitutes to each other.
- Firms try to differentiate their product from the competition through advertising and other non-price strategies.
- There are low barriers to entry and exit.
- Firms have some degree of pricing power.

Demand and Supply Analysis in Monopolistically Competitive Markets

Demand:

- Each firm faces a downward sloping demand curve.
- Demand is relatively elastic at higher prices and relatively inelastic at lower prices.

Supply:

- There is no well-defined supply function.
- Neither the MC nor the AC curve represent the firm's supply curve.
- The firm will always produce at the output level where $MC = MR$.
- The price that is charged is derived from the market demand curve.

