Monopolistic competition is first identified in the 1930s by American economist[**Edward Chamberlin**](http://www.economyprofessor.com/theorists/edwardchamberlin.php), and English economist [**Joan Robinson**](http://www.britannica.com/EBchecked/topic/505744/Joan-Robinson).Monopolistic Competition refers to a market situation in which there are large numbers of firms which sell closely related but differentiated products. Markets of products like soap, toothpaste AC, etc. are examples of monopolistic competition.

**Monopoly + Competition = Monopolistic Competition**

Under monopolistic competition, each firm is the sole producer of a particular brand or “product

i. It enjoys ‘monopoly position’ as far as a particular brand is concerned.

ii. however, since the various brands are close substitutes, its monopoly position is influenced due to stiff ‘competition’ from other firms.

So, monopolistic competition is a market structure, where there is competition among a large number of monopolists.

**Example of Monopolistic Competition: Toothpaste Market:**

When you walk into a departmental store to buy toothpaste, you will find a number of brands, like Pepsodent, Colgate, Neem, Babool, etc.

i. On one hand, the market for toothpaste seems to be full of competition, with thousands of competing brands and freedom of entry.

ii. On the other hand, its market seems to be monopolistic, due to uniqueness of each toothpaste and power to charge different price.

Such a market for toothpaste is a monopolistic competitive market.

Let us now discuss some of the important features of this kind of market.

**Features of Monopolistic Competition:**

# 1. A large number of firms:

The first important feature of monopolistic competition is that under it there are a relatively large number of firms each satisfying a small share of the market demand for the product. Because there are a large number of firms under monopolistic competition, there exists stiff competition between them.

Unlike perfect competition these large number of firms do not produce identical products. Instead, they produce and sell differentiated products which are close substitutes of each other. This makes the competition among firms real and tough. Further, the fact that there are a large number of firms under monopolistic competition; size of each firm will be relatively small. This is unlike oligopoly where there are a few firms of big size.

# 2. Product Differentiation:

Each firm is in a position to exercise some degree of monopoly (in spite of large number of sellers) through product differentiation. Product differentiation refers to differentiating the products on the basis of brand, size, colour, shape, etc. The product of a firm is close, but not perfect substitute of other firm.

Implication of ‘Product differentiation’ is that buyers of a product differentiate between the same products produced by different firms. Therefore, they are also willing to pay different prices for the same product produced by different firms. This gives some monopoly power to an individual firm to influence market price of its product.

**Explore More about Product Differentiation:**

1. The product of each individual firm is identified and distinguished from the products of other firms due to product differentiation.

2. To differentiate the products, firms sell their products with different brand names, like Lux, Dove, Lifebuoy, etc.

3. The differentiation among different competing products may be based on either ‘real’ or ‘imaginary’ differences.

(i) Real Differences may be due to differences in shape, flavour, colour, packing, after sale service, warranty period, etc.

(ii) Imaginary Differences mean differences which are not really obvious but buyers are made to believe that such differences exist through selling costs (advertising).

4. Product differentiation creates a monopoly position for a firm.

5. Higher degree of product differentiation (i.e. better brand image) makes demand for the product less elastic and enables the firm to charge a price higher than its competitor’s products. For example, Pepsodent is costlier than Babool.

6. Some more examples of Product Differentiation:

(i) Toothpaste: Pepsodent, Colgate, Neem, Babool, etc.

(ii) Cycles: Atlas, Hero, Avon, etc.

# 3. Freedom of entry and exit:

This is another important feature of monopolistic competition. In a monopolistically competitive industry it is easy for the new firms to enter and the existing firms to leave it. Free entry means that when in the industry existing firms are making super-normal profits, the new firms enter the industry which leads to the expansion of output.

As a result, price of product tends to fall in the long run. However, it may be noted that under monopolistic competition entry may not be as easy or free as under perfect competition. Whereas under perfect competition the new firms which enter the industry can produce identical products, but under monopolistic competition, the new firms can produce only new brands or product varieties which may initially find it difficult to compete with the already well-established brands and product varieties.

# 4. Lack of Perfect Knowledge:

The buyers and sellers do not have perfect knowledge of the market. There are innumerable products each being a close substitute of the other. The buyers do not know about all these products, their qualities prices.

# 5. Some influence over the price:

Each firm under monopolistic competition produces a product variety which is close substitute of others. Therefore, if a firm lowers the price of its product variety, some customers of other product varieties will switch over to it.

This means as it lowers the price of its product variety; quantity demanded of it will increase. On the other hand, if it raises the price of its product, some of its customers will leave it and buy the similar products from its competing firms.

This implies that demand curve facing a firm working under monopolistic competition slopes downward and marginal revenue curve lies below it. This means that under monopolistic competition an indi­vidual firm is not a price taker but will have some influence over the price of its product.

If it fixes a higher price, it will be able to sell a relatively smaller quantity of output. And if it fixes a lower price, it will be able to sell more. Thus under monopolistic competition, a firm has to choose a price-output combination which will maximise its profits.

# 6. Non-price competition: Expenditure on advertisement and other selling costs:

An important feature of monopolistic competition is that firms incur a considerable expenditure on advertisements and other selling costs to promote the sales of their products. Promoting sales of their products through advertisement is an important example of non-price competition.

The expenditure incurred on advertisement is prominent among the various types of selling costs. The advertisement and other selling outlays by a firm change the demand for its product as well as its costs. Like the adjustments of price and product, a seller under monopolistic competition will also adjust the amount of his advertisement expenditure so as to maximise his profits.

This problem of adjusting one’s selling outlay is unique to monopolistic competition, because the firm under perfect competition has not to incur any expenditure on advertisement. The advertisement expenditure by a purely competitive firm will be without purpose since it can sell as much amount as it pleases at the going market price without any advertisement expenditure.

The rival firms under monopolistic competition keenly compete **5. Product variation:**

Another form of non-price competition which a firm under monopolistic competition has to face is the variation in products by various firms. A firm, under perfect competition, does not confront this problem, for the product is homogeneous under perfect competition.

The problem of product variation under monopolistic competition exists because there is differentiation of products of various firms. The firm will try to adjust its product so as to conform more to the wishes of the buyers. The variation of the product may refer to a change in the quality of the product itself, technical changes, a new design, better materials, and it may mean only a new package or container.

It may also mean more prompt or courteous service, and a different way of doing business. The amount of the product which a firm will be able to sell in the market depends in part upon the manner in which its product differs from others.

Where the possibility of product differentiation exists, sales depend upon the skill with which a product is distinguished from others and made to appeal to a particular group of buyers. The profit maximisation principle applies to the choice of the nature of the product as to its price.

In other words, a firm will choose that nature of the product, given its price, which gives it maximum profits. Therefore, in a full explanation of the firm’s equilibrium under mo­nopolistic competition we have also to explain product equilibrium in addition to price equilibrium and selling-costs equilibrium.

7. Less Mobility**:**

Under monopolistic competition both the factors of production as well as goods and services are not perfectly mobile.

# 8,More elastic Demand:

Under monopolistic competition, demand curve is more elastic. In order to sell more, the firms must reduce its price.

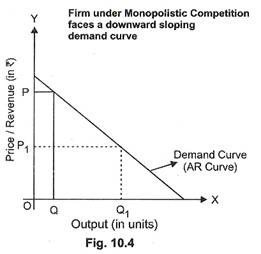
9.Absence of firm interdependence**:**

Under oligopoly, the firms are dependent upon each other and can't fix up price independently. But under monopolistic competition the case is not so. Under monopolistic competition each firm acts more or less independently. Each firm formulates its own price-output policy upon its own demand cost

**Demand Curve under Monopolistic Competition:**

Under monopolistic competition, large number of firms selling closely related but differentiated products makes the demand curve downward sloping. It implies that a firm can sell more output only by reducing the price of its product.

As seen in Fig. 10.4, output is measured along the X-axis and price and revenue along the Y-axis. At OP price, a seller can sell OQ quantity. Demand rises to OQ1, when price is reduced to OP1. So, demand curve under monopolistic competition is negatively sloped as more quantity can be sold only at a lower price.

**[](http://cdn.yourarticlelibrary.com/wp-content/uploads/2013/09/clip_image00254.jpg)**

**MR < AR under Monopolistic Competition:**

Like monopoly, MR is also less than AR under monopolistic competition due to negatively sloped demand curve.

CONCLUSION

[Monopolistic competition](http://economicskey.com/monopolistic-competition-3648) is true to its name: It is a hybrid of monopoly and competition. Like a monopoly, each monopolistic competitor faces a downward-sloping demand curve and, as a result, charges a price above marginal cost. As in a perfectly competitive market, there are many firms, and entry and exit  drive the profit of each monopolistic competitor toward zero. Table 1 summarizes these lessons .

Because monopolistically competitive firms produce differentiated products, each firm advertises to  customers to its own brand. To some extent, advertising manipulates consumers’ tastes, promotes irrational brand loyalty, and impedes competition. To a larger extent, advertising provides information, establishes brand names of reliable quality, and fosters competition.

The theory of [monopolistic competition](http://economicskey.com/monopolistic-competition-4-8774) seems to describe. many markets in the economy. It is somewhat disappointing, therefore, that the theory does not yield simple and compelling advice for public policy. From the standpoint of the economic theorist, the allocation of resources in monopolistically competitive markets is not perfect. Yet from the standpoint of a practical policymaker, there may be little that can be done tMonopolistic Competition

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