## Monopolistic Competition

- On one extreme is the Perfect Competition model
- On the other extreme is the Monopoly Model
- Monopolistic Competition & Oligopoly are competitive scenarios that lie between these two extremes
- Therefore, competitive features of Monopolistic Competition and Oligopoly will emulate either Perfect Competition or Monopoly

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## Characteristics of Monopolistic Competition

- Power to set prices somewhat like a monopoly
- Face competition like perfect competition

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- Large number of firms
  - -- Each firm has relatively small market share
  - -- Each firm must be sensitive to average market price of its product
  - -- Collusion is not possible due to the number of firms
- No barriers to entry or exit

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## Characteristics of Monopolistic Competition

- Product Differentiation – Each firm makes a product that is slightly different from the products of competing firms.
  - -- Close substitutes but no perfect substitutes
  - -- An attempt to increase price will normally results in a lower volume sold
- Competition on Quality, Price, Marketing
  - -- Quality is design, reliability, service provided to buyer and ease of access to product
  - -- Price – downward sloping demand curve
  - -- Marketing – firm must market = promotion, distribution, packaging

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## The Typical Monopolistic Competitor

- **The monopolistic competitor tries to set his or her product apart from the competition**
- **The main way of doing this is through advertising**
  - **When this is done successfully, the demand curve becomes more vertical or inelastic**
    - **Buyers are willing to pay more for a product or service because they believe it is much better than their other choices**

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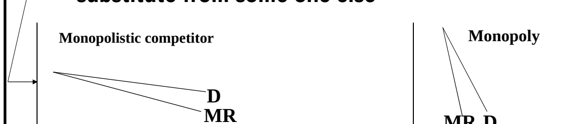
## The Monopolistic Competitor in the Short Run

- **The monopolistic competitor can make a profit or take a loss**
- **As only one firm in a crowded industry it has a very elastic demand curve**
- **No one firm can get too far out of line on price because buyers can always purchase a substitute from some one else**

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## Monopolistic Competitor Making a Profit in the Short Run

## Monopolistic Competitor Taking a Loss in the Short Run

## Monopolistic Competitor Breaking Even in the Long Run

## Is the Monopolistic Competitor Inefficient?

- **From a purely economic standpoint . . .Yes!**
  - **The firms do not produce at the minimum point on the ATC**
  - **There may be too many firms in most industries**
    - **Are there too many beauty parlors? Not if you want to get your hair done on Friday afternoon or Saturday morning**
    - **Are there too many restaurants? Not on Sunday**
  - **There may be overdifferentiation**
    - **Would Americans want the drab businesses that characterize eastern Europe and the old soviet union?**
    - **Would Americans want only one brand of toothpaste or one brand and model of a car?**
  - **In America, it would be hard to imagine a no-frills world**

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## Closing Thoughts

- More than 99% of the over 23 million business firms in the United States are monopolistic competitors
- While price competition exists, they compete more vigorously over differentiation characteristics such as ambience, service, convenience, quality, brand awareness, etc.