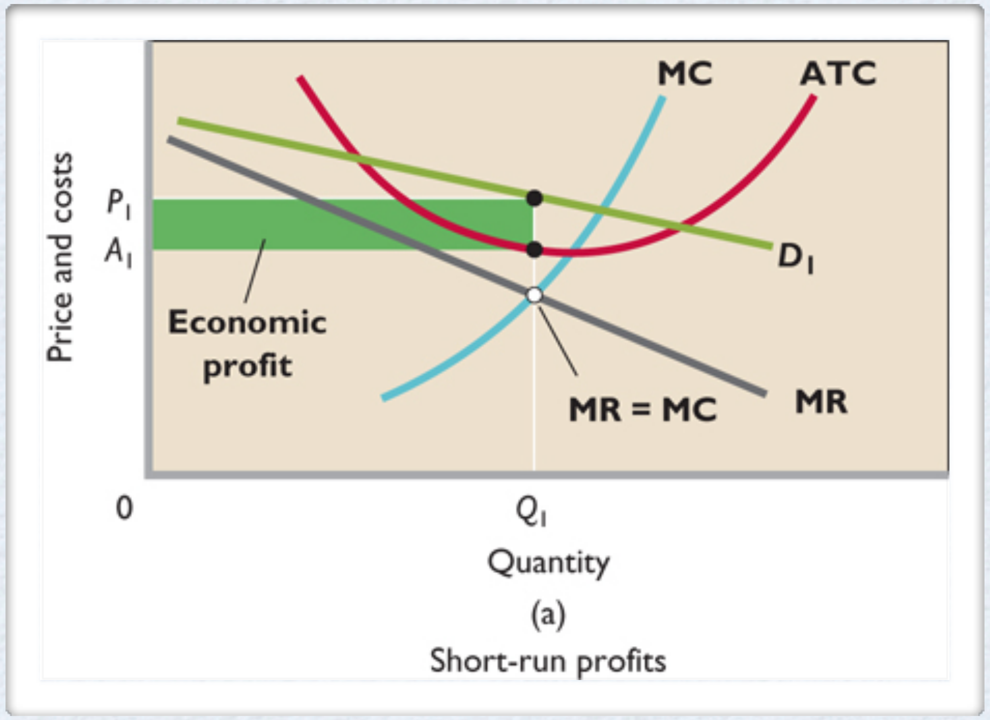
CHAPTER 9

Monopolistic Competition

- **Monopolistic competition**
    - Relatively large number of sellers in the market
        - small market shares
        - no collusion - to restrict output and set prices is unlikely
        - independent action
    - Differentiated products
    - Easy entry and exit
    - Advertising - heavy
- Monopolistically competitive industries - computers, leather goods, aircraft manufacturing ... monopolistically competitive firm is a price maker - unique products

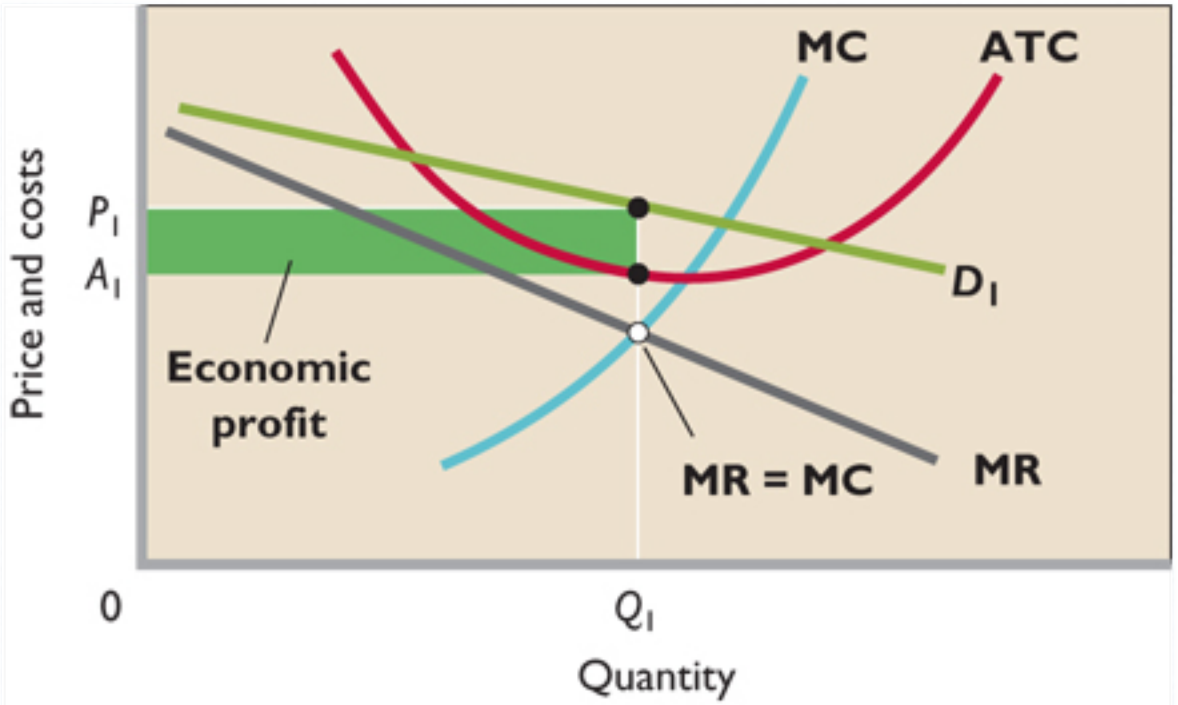
Monopolistic Competition

- **Price and output in monopolistic competition**
  - The firm's demand curve
    - The demand curve is highly but not perfectly elastic - reason:
      1. Monopolistic competition has fewer rivals
      2. Products are differentiated, no perfect substitutes

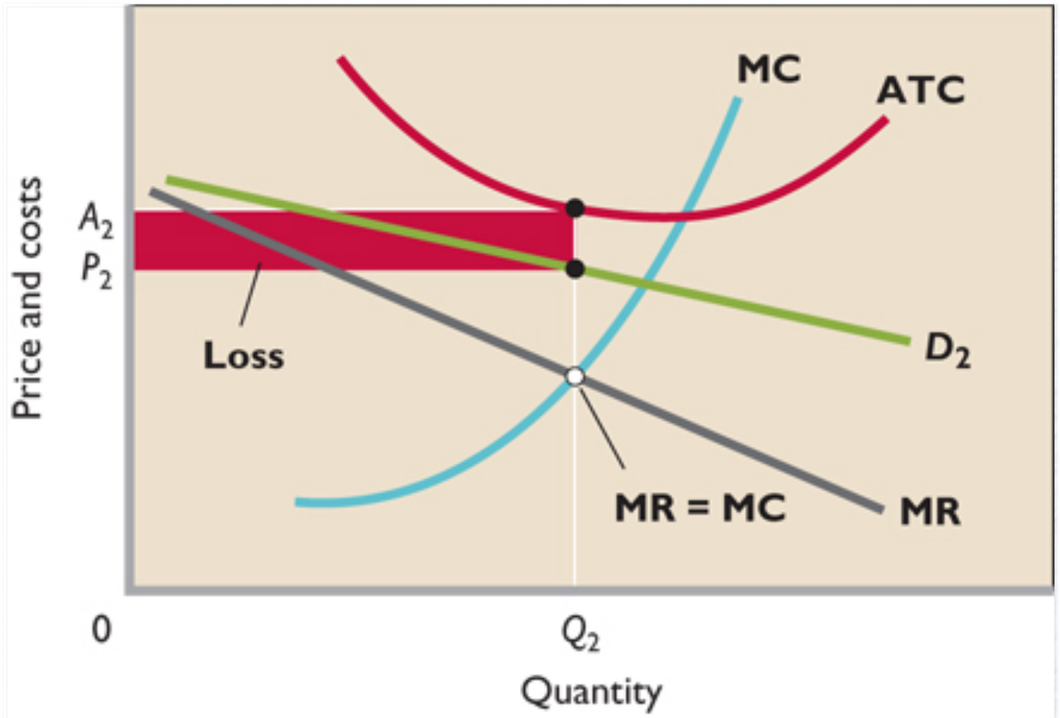


Monopolistic Competition

- Short-run profit/loss



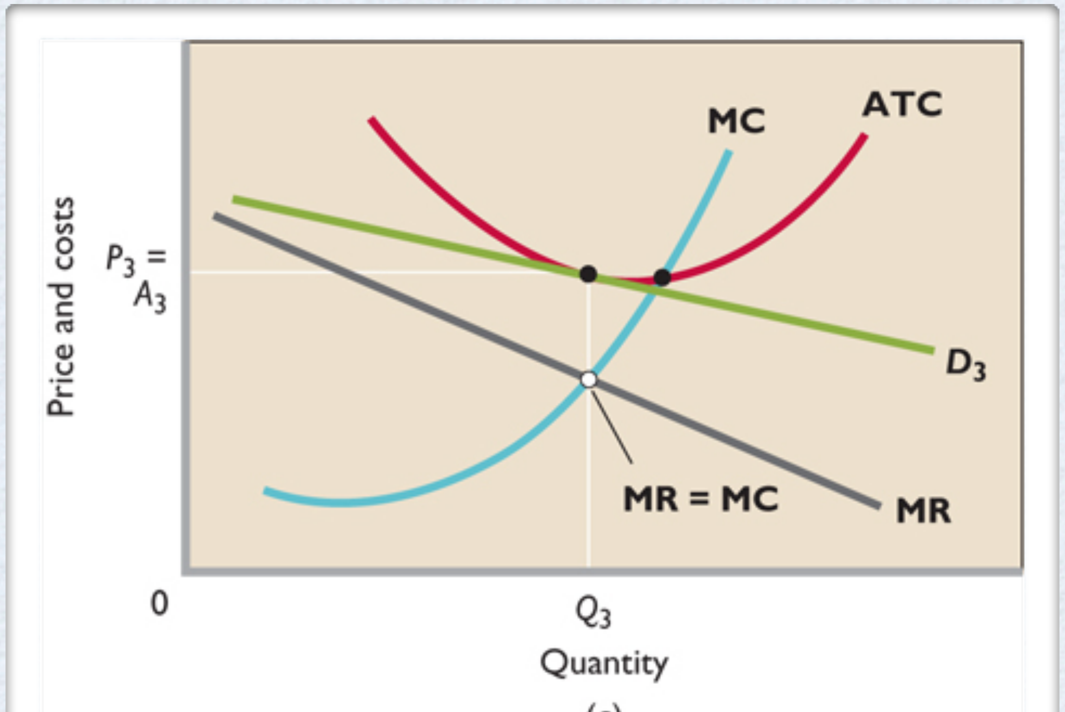
(a)
Short-run profits



(b)
Short-run losses

Monopolistic Competition

- **Long-run - in the long-run, for the monopolistic competitor there is only normal profit.**
  - **If there is a profit**, firms will enter into the industry, D curve shifts to the left (each firm has a smaller share of the total demand and now faces a large number of close substitute products), D will eventually be tangent to ATC, hence in the long-run only normal profit exists.
  - **If there is a loss**, firms will leave, D curve shifts to the right, D will reach ATC, only normal profit exists.



(c)
Long-run equilibrium

Oligopoly

- **Characteristics of oligopoly**
  - There are a few large producers
  - Homogeneous or differentiated products (considerable non-price competition - heavy advertising
  - The individual firm is a “price maker” but there is still mutual interdependence
  - Entry into the industry is difficult
  - Mergers

Oligopoly

- **Price leadership** - a dominant firm initiates price changes and the rest of the firms follow
- **Oligopoly and advertising** - Advertising is preferred than competition based on price
    - They are less easily duplicated
    - Must have sufficient financial resources