Monopolistic Competition

Today's Topics: Brands and Advertising

1. **Between Monopoly and Perfect Competition:** (pp. 320–322) number of sellers? type of products? oligopolies, monopolistic competition.

2. **Monopolistic Competition:** (pp. 368–373) competition in the short run, in the long run; compared with perfect competition, and efficiency.

3. **Advertising:** (pp. 374–379) pros and cons, as a signal of quality, brand names.

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1. Between Two Poles

	Number of Sellers:		
	One	**A Few**	**Many**
Homogenous Product	*Pure Monopoly*	*Homogeneous Oligopoly*	*Pure Competition*
Differentiated Product		*Differentiated Oligopoly*	*Monopolistic Competition*

Assume: *Many Buyers*

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Oligopoly: **a market structure in which only a few sellers offer similar or identical products. Often behave strategically. (Next lecture.) Examples?**

Monopolistic Competition: **a market structure in which many firms sell products that are similar but not identical.**
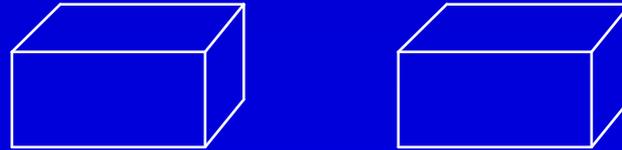
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Differentiated Products

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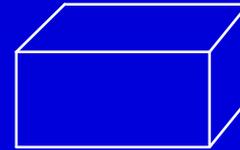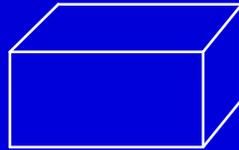
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Degree of Substitutability?

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5. Buyers are price takers; *no bargaining*.

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Five points:

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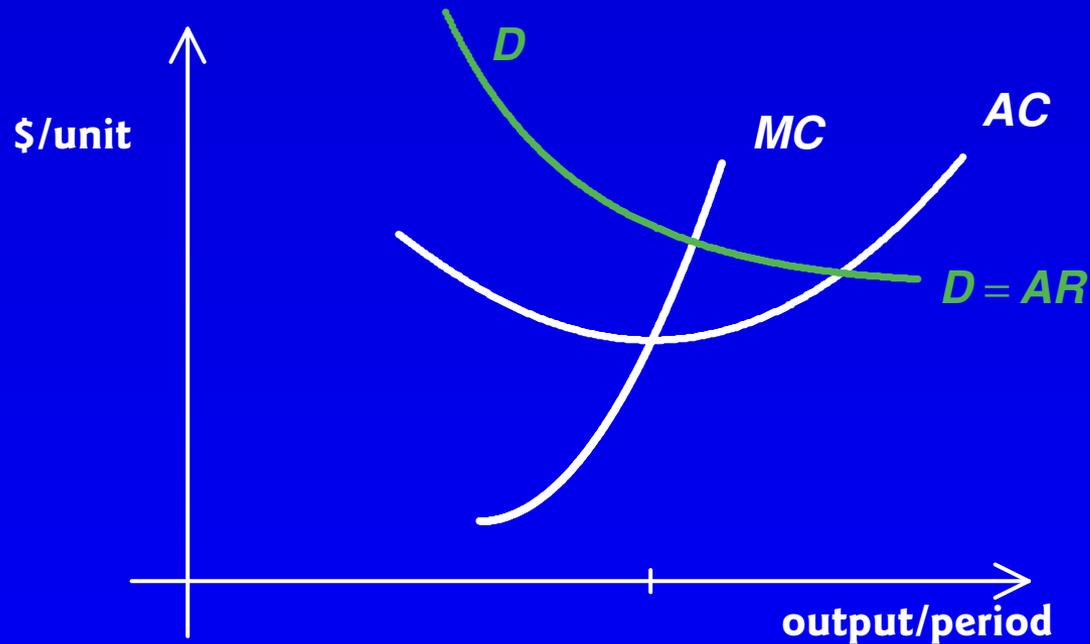   **$\therefore$ attractive for new firms to produce close substitutes in the long run.**

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Positive Profits
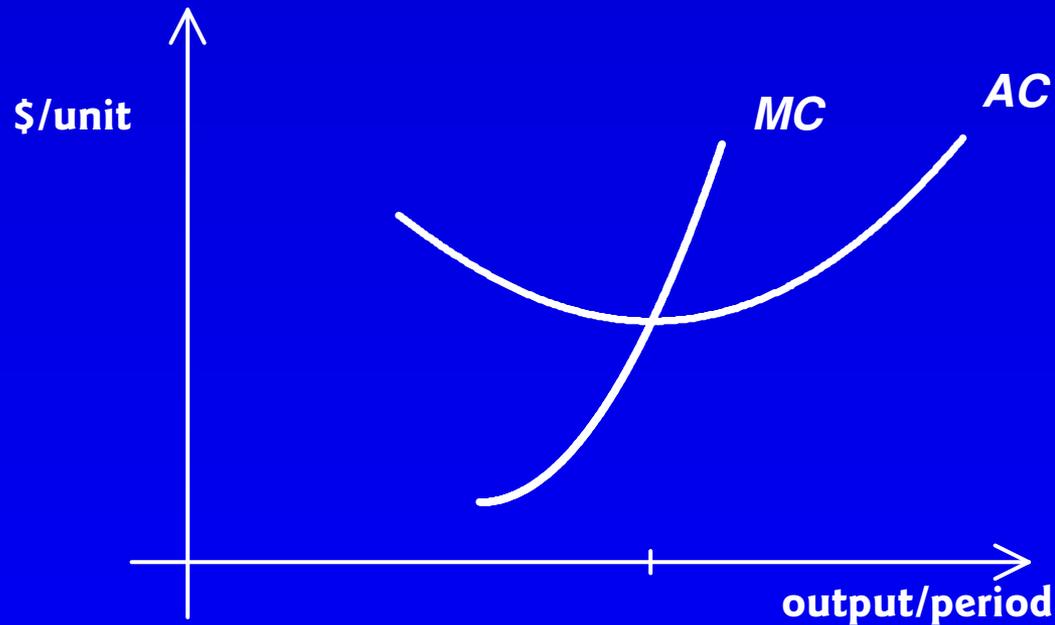
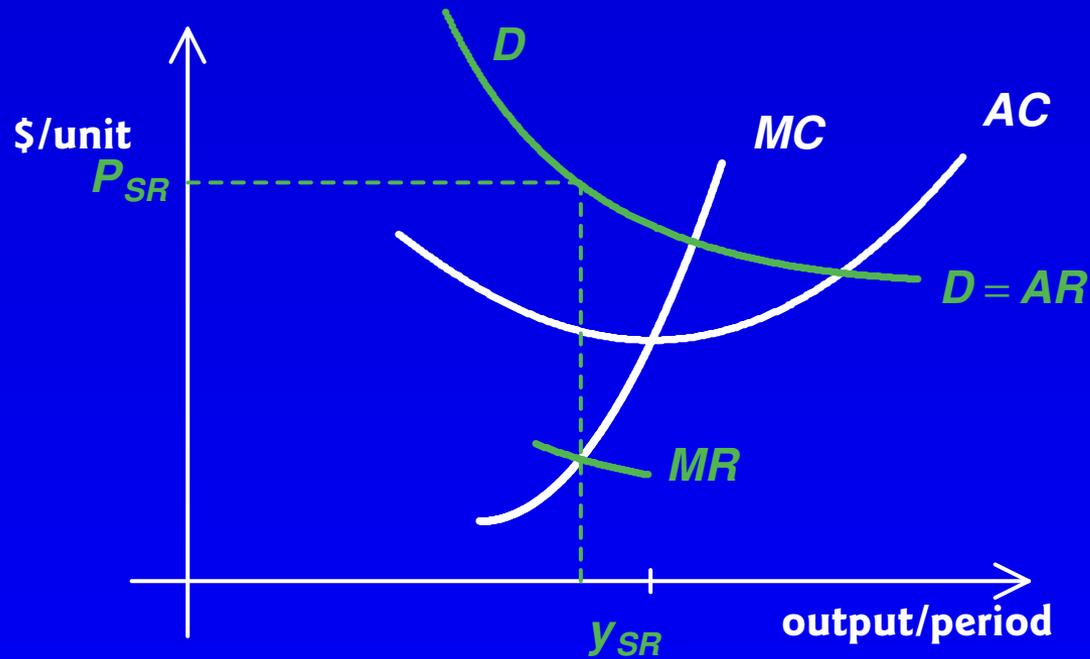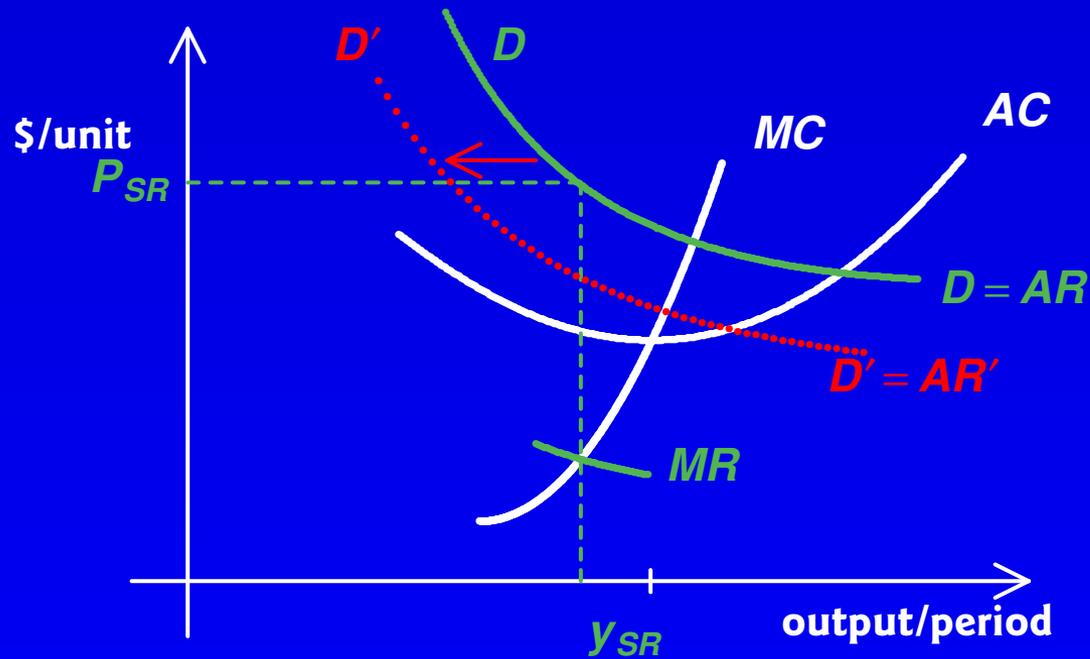**(The firm's cost and revenue curves, not the market's.)**

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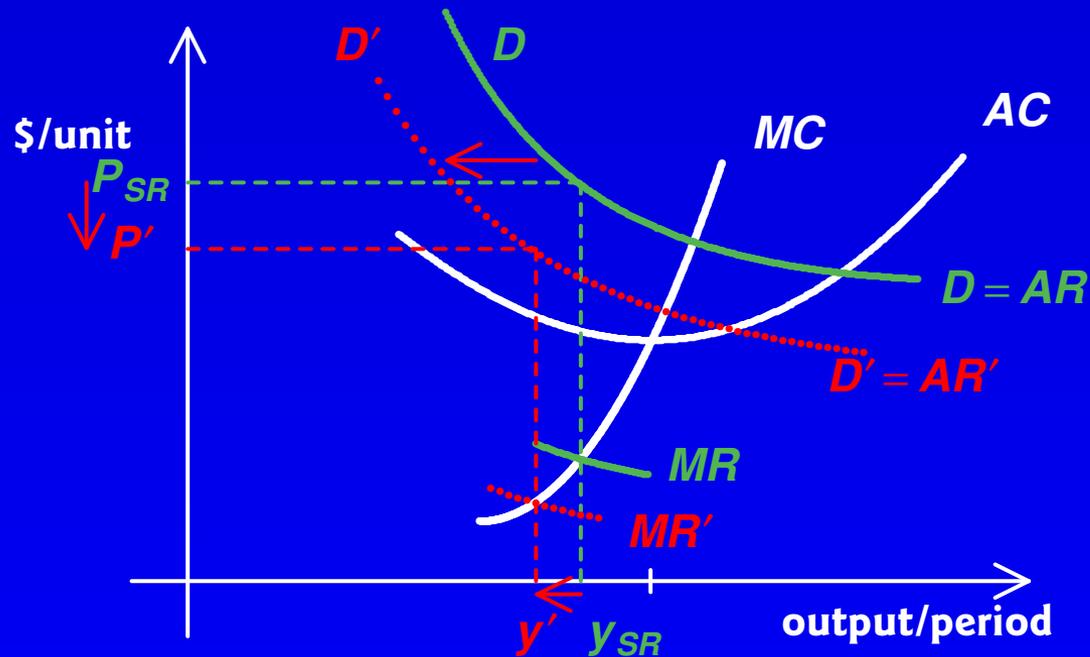
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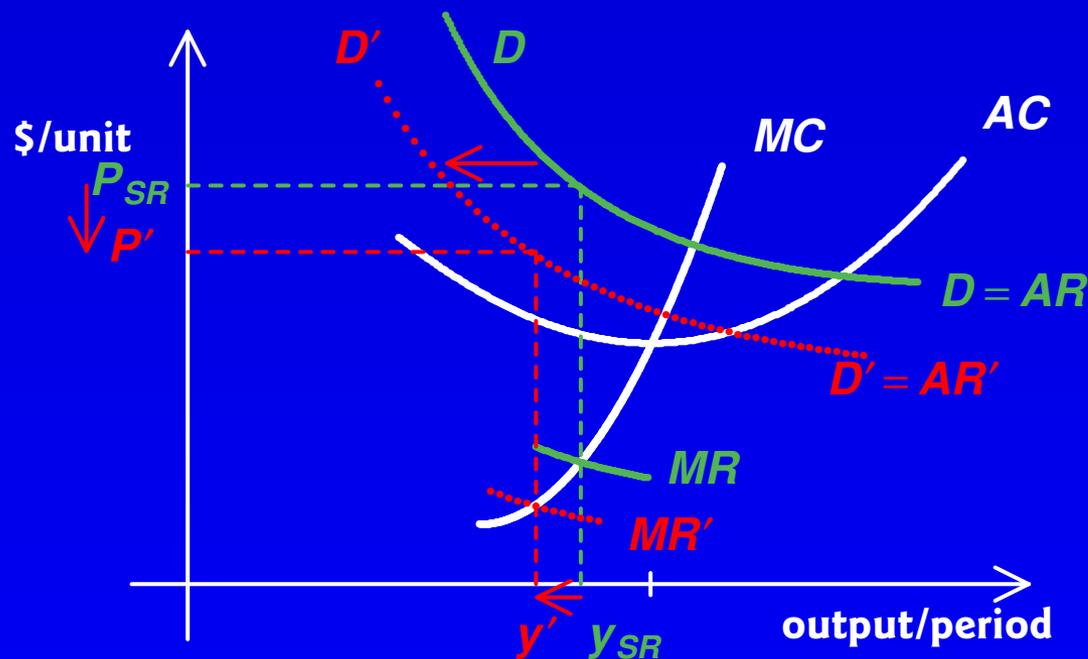
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Profit falls, but still positive: $AR'(y') = P' > AC(y')$.
Profit always maximised: $MR(y) = MC(y)$.

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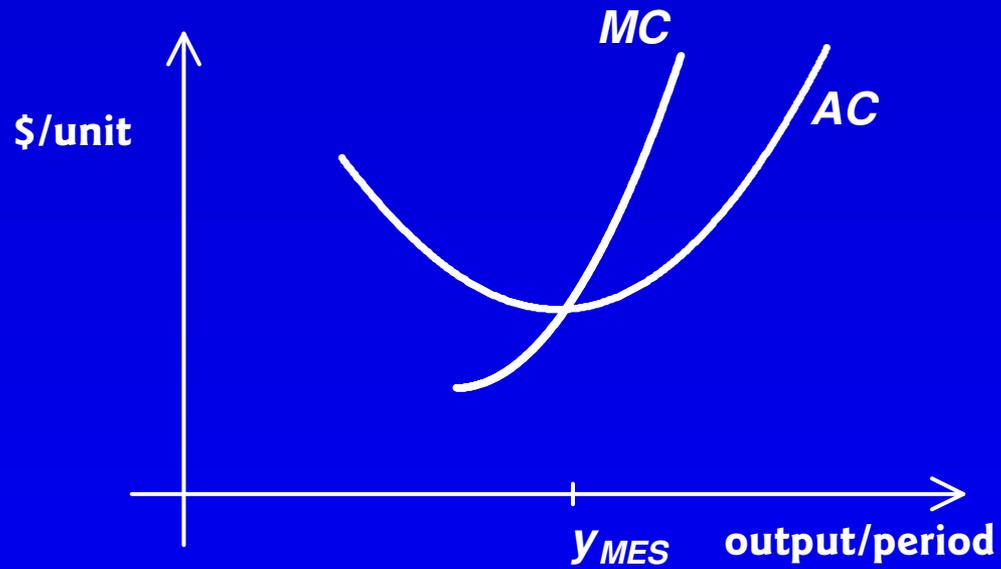
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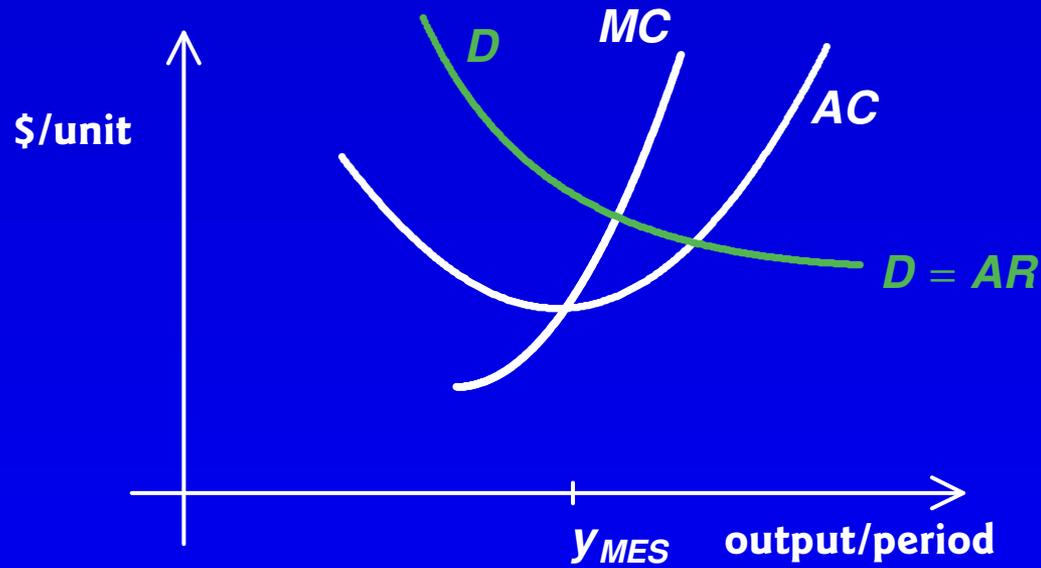
    $\therefore$ the demand curve D'' must be tangent to the AC curve at the price P'' & output y'' chosen.

    & any further contraction of the firm's demand $\rightarrow$ negative profits.
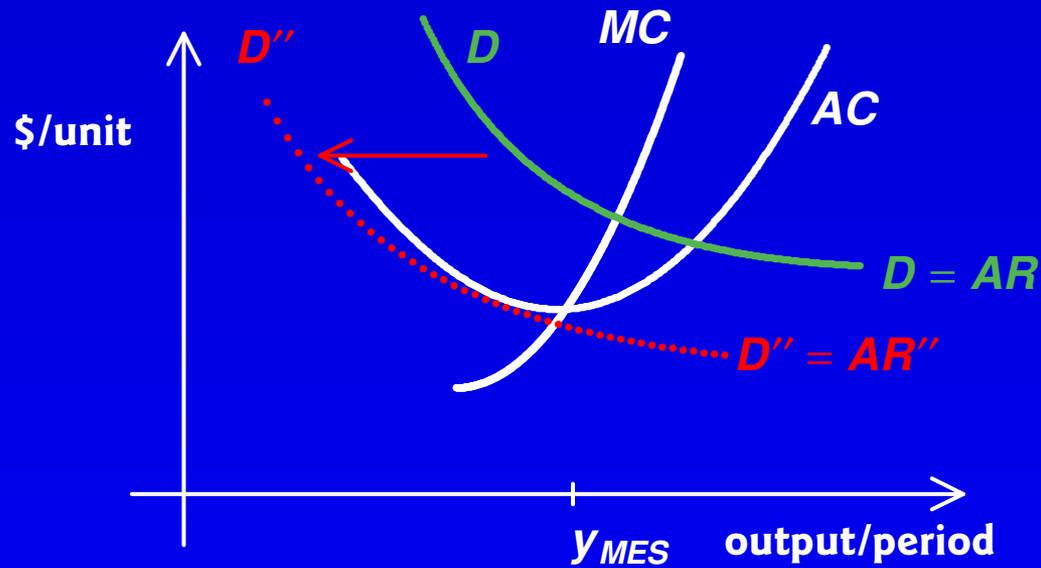
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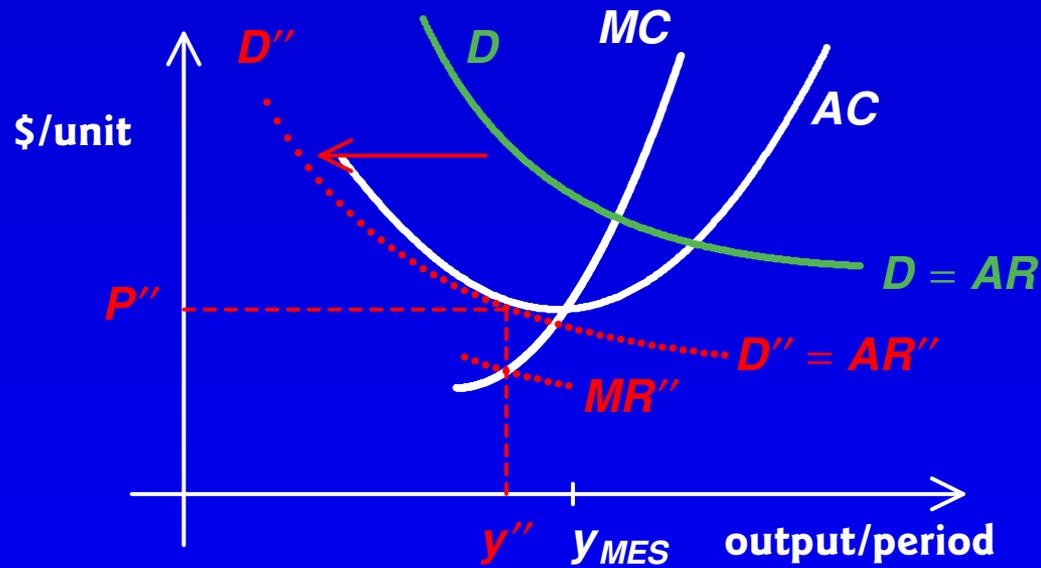
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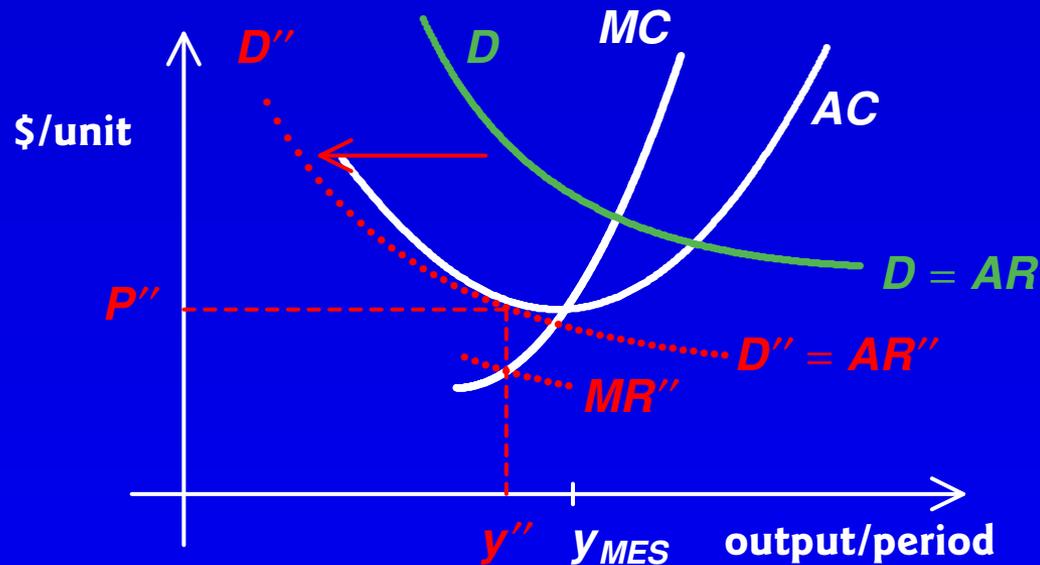
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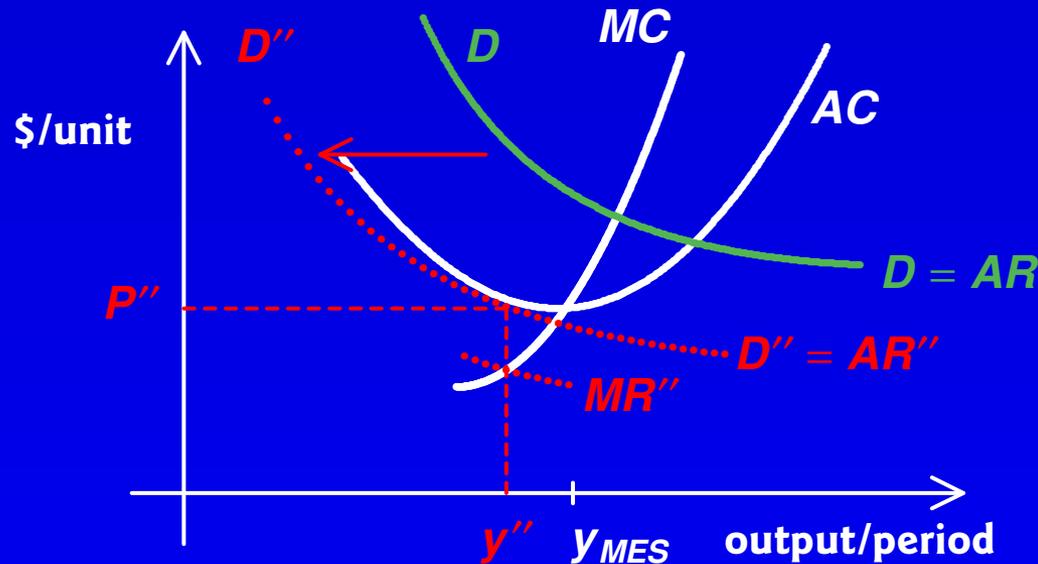
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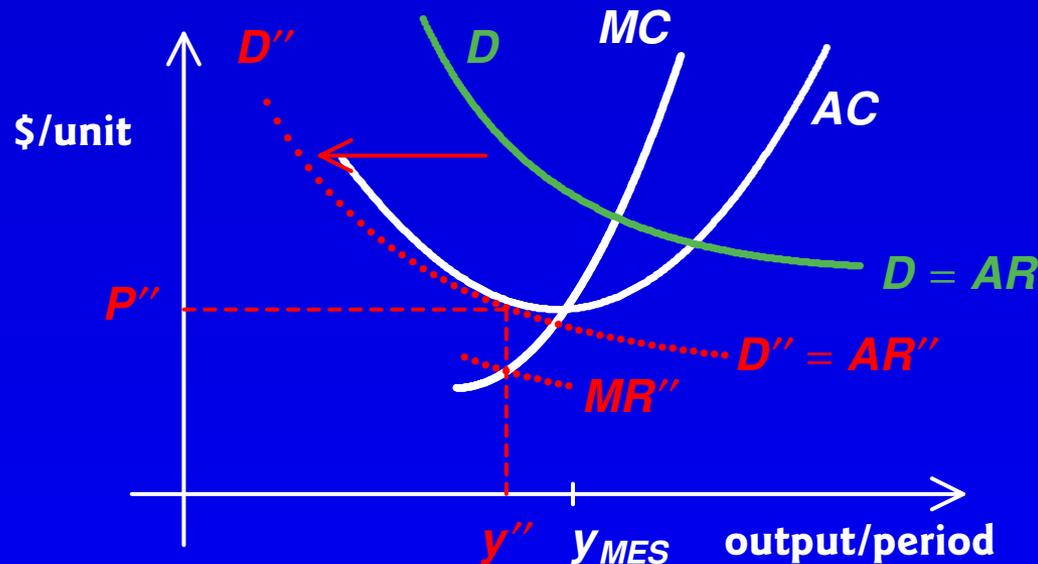
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$\therefore$ Firms are always eager to make another sale: an extra unit sold at the current price means more profit, not unwilling.

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Summary

1. **Between monopoly and perfect competition lie most markets: oligopolies (few sellers) or monopolistic competition (many sellers).**

2. **Monopolistic Competition: Neither perfect competition, nor pure monopoly: many sellers and zero profit, but with a price mark-up: $P > MC$.**

3. **Many products → variety for consumers!**

4. **Advertising to increase sales. Justified or not?**

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Appendix

Under what conditions is it true that the slope $\frac{dMR}{dQ}$ of the *MR* curve is twice that $\frac{dP}{dQ}$ of the *AR* (i.e demand) curve?

Now revenue $R = Q \cdot P(Q)$

$$\therefore \ MR \equiv \frac{dR}{dQ} = P(Q) + Q\,\frac{dP}{dQ} = P \cdot (1 + \frac{1}{\eta}),$$
where η is the price elasticity of demand.

$\therefore$ The slope of the *MR* curve is given by:

$$\frac{dMR}{dQ} = 2\,\frac{dP}{dQ} + Q\,\frac{d^2P}{dQ^2}$$

So it is only true in general for linear demand curves, for which $\frac{d^2P}{dQ^2} = \frac{d}{dQ}\left(\frac{dP}{dQ}\right) = 0$, because their slopes are constant (but not, of course, their elasticities).