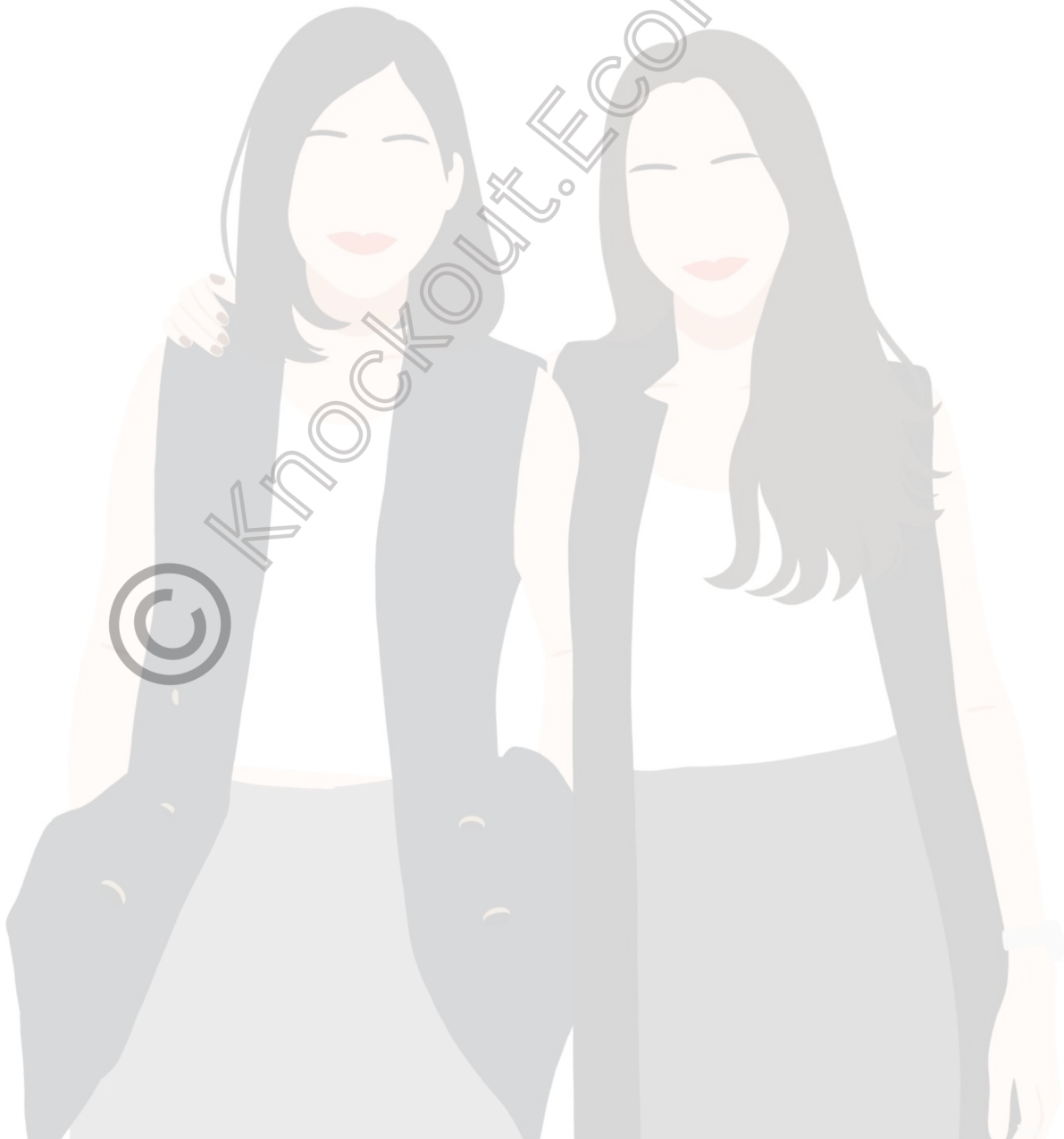


CHAPTER 11 : Monopolistic competition

Key terms

1. Monopolistic competition : a market structure where a large number of small firms produces non-homogenous products and where there are no barriers to entry or exit

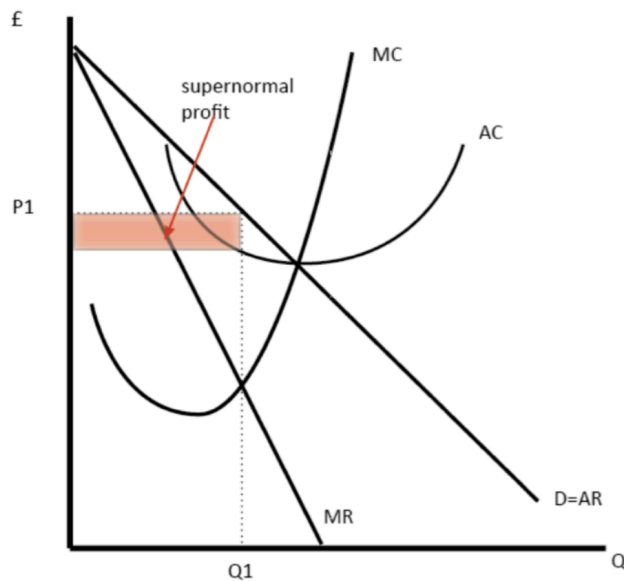


1. Characteristics of monopolistic

- Many firms in the market
- Imperfect knowledge
- Freedom of entry and exit. Low barrier to entry
- Similar goods but with brand different

2. Short run monopolistic competition

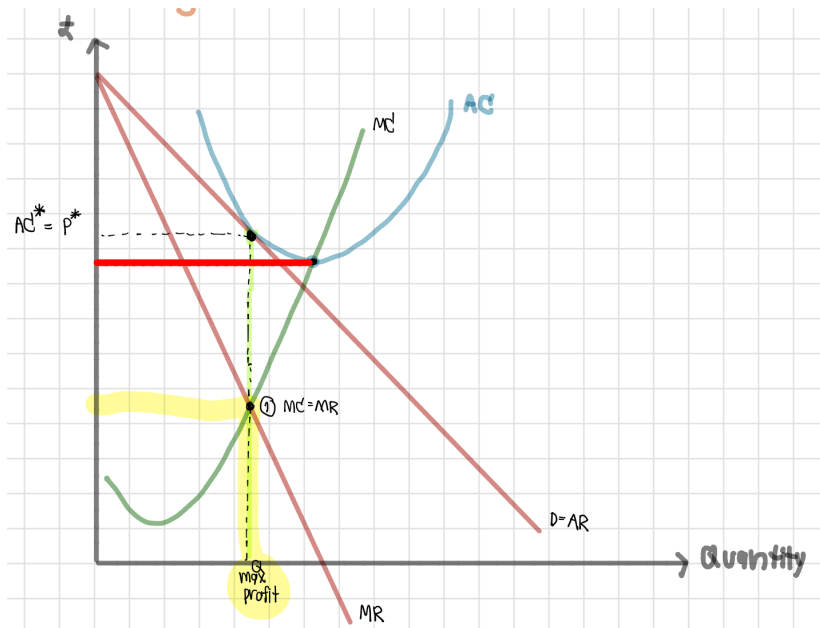
Diagram



- To find out max. Profit , $MR = MC$
- At Q_1 , it can generate supernormal profit $(P_1 - AC) \times Q_1$

3. Long run monopolistic competition

Diagram



- In long run, new firms are able to enter to market because of freedom of entry
- As new firms enter, the demand curve for initial firms shift to the left until normal profit is made
- To find point @ max profit , $MR=MC$ ($P^*=AC^*$), in this case normal profit is made

Limitations

1. Some firms will be better brand differentiation, and therefore, in the real world firm can generate supernormal profit. New firms will not be seen as a close substitute
2. It depends how customers define market
3. If a firm has strong brand loyalty, it can create barrier to entry

4. Advantages and disadvantages of monopolistic

Advantages	Disadvantages
<p>1. Dynamic efficiency in Short run as $P^* > AC^*$</p> <p>: Firms can reinvest in innovation and technology</p> <p>: LRAC will be lower</p> <p>2. More profitable than in perfect competition</p> <p>3. High competition</p> <p>: makes incentive for firms to respond customer wants</p> <p>: More variety of product</p> <p>: Better standard of living</p> <p>4. Model of monopolistic company is more realistic than perfect competition</p>	<p>1. Allocative inefficiency both short run and long run</p> <p>2. Dynamic inefficiency in long run</p> <p>3. Productive inefficiency for both short run and long run</p> <p>4. Price is higher than perfect competition</p> <p>: Consumers may less affordable and lower standard of living</p> <p>5. Firms cannot take advantages of Economies of scales</p>