Introduction to Economics I
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Monopolistic competition

Monopolistic competition is a type of imperfect competition such that many producers sell products that are differentiated from one another (e.g. by branding or quality) and hence are not perfect substitutes.

In monopolistic competition, a firm takes the prices charged by its rivals as given and ignores the impact of its own prices on the prices of other firms.

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Monopolistically competitive markets have the following characteristics:

There are many producers and many consumers in the market, and no business has total control over the market price.

Consumers perceive that there are non-price differences among the competitors' products.

There are few barriers to entry and exit.

Producers have a degree of control over price.

The principal goal of the firm is to maximize its profits.

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Monopolistically competitive markets have the following characteristics:

Factor prices and technology are given.

A firm is assumed to behave as if it knew its demand and cost curves with certainty.

The decision regarding price and output of any firm does not affect the behavior of other firms in a group,i.e., impact of the decision made by a single firm is spread sufficiently evenly across the entire group. Thus, there is no conscious rivalry among the firms.

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Monopolistically competitive markets have the following characteristics:

Each firm earns only normal profit in the long run.

Each firm spends substantial amount on advertisement. The publicity and advertisement costs are known as selling costs.

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Product differentiation

Product differentiation is a marketing strategy that strives to distinguish a company's products or services from the competition.

There are 2 types of product differentiation:

1. Horizontal
2. Vertical

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Product differentiation

There are two types of product differentiation:

Horizontal: based on a single characteristic but consumers are not clear on quality.

Vertical: based on a single characteristic and consumers are clear on its quality.

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Profit maximizing rule:

MR=MC.

Each firm has a market power (due to product differentiation).

P>MC.

Combining these results we have:

P>MR=MC.