Chapter 7:3  Monopolistic Competition and Oligopoly
• We will study the characteristics and examples of monopolistic competition.
• Examine how firms compete without lowering prices.
• Understanding how firms in a monopolistic competitive market set output.
• Study characteristics and examples that give oligopoly.
• (Mar 8:36) For what shall it profit a man, if he shall gain the whole world, and lose his own soul?
Monopolistic Competition:

• In Monopolistic competition, many companies compete in an open market to sell products that are similar but not identical.

• Each firm is monopolistic, it holds a monopoly over its own particular product design.

• You can think of monopolistic competition as a modified version of perfect competition with minor differences in products.
Monopolistic Competition:

• Monopolistic competition does not involve identical commodities.
• An example of a monopolistically competitive market is the market for jeans.
• All jeans can be described as denim pants but in stores, buyers can choose from a variety of brand names, styles, colors, and sizes.
Monopolistic Competition:

- Unlike perfect competition, monopolistic competition is a fact of everyday life.
- Common examples include bagel shops, ice cream stands, gas stations, and retail stores.
Four Conditions of Monopolistic Competition:

• (1) Many Firms: As a rule, monopolistically competitive markets are not marked by economies of scale.
• They do not have high startup costs.
• Because firms can begin selling goods and earning money after a small initial investment, new firms spring up quickly to join the market.
• (2) Few artificial barriers to entry: Firms in a monopolistically competitive market do not face the high barriers to entry.
• Patents does not protect everyone from competition, either because they have expired or because each firm sells a product that is distinct enough to fall outside the zone of patent protection.
Four Conditions of Monopolistic Competition:

• Just like perfectly competitive market, includes so many competing firms, that producers cannot work together to keep out new competitors.
Four Conditions of Monopolistic Competition:

• (3) Little Control over Price:
  • Each firm’s goods are a little different from everyone’s else and some people are willing to pay more for the difference.
  • For this reason, firms have a bit of freedom to raise or lower their prices.
  • However, unlike a monopoly, a monopolistically competitive firm has only limited control over price.
  • If prices rise too high, consumers will buy a rival product because close substitutes are readily available.
Four Conditions of Monopolistic Competition:

• For example people would most likely buy a carton of brand name orange juice over store brand even if it cost 50 cents more.

• If the difference in price rose to $2 more per carton, most people would think seriously about buying the store brand of orange juice or some other drink altogether.
Four Conditions of Monopolistic Competition:

• (4) Differentiated Products: Firms have some control over their selling price because they can differentiate or distinguish their goods from the other products in the market.
• The ability to differentiate goods is the main way that monopolistic competition differs from perfect competition.
• Differentiation enables a monopolistically competitive seller to profit from the differences between his or her products and competitors’ products.
What is the maximum price you are willing to pay for?
What is the maximum price you are willing to pay for? Going out to eat?
What is the maximum price you are willing to pay for?
Are you willing to pay more for a brand?
Non Price Competition:

• The ability to differentiate products means that firms do not have to compete on price alone.
• The alternative is non price competition or competition through ways other than lower prices.
• Non price competition takes several different forms.
Physical Characteristics:

• The simplest way for a firm to distinguish its product is to offer a new size, color, shape, texture, or taste.
Location:

- Some goods can be differentiated by where they are sold.
- Gas stations, grocery stores, and restaurants succeed or fail based on their locations.
- A convenience store in the middle of a desert differentiates its product simply by selling it hundreds of miles away from the nearest competitors.
Service Level:

• Some sellers can charge higher prices because they offer their customers a high level of service.
• Conventional restaurants and fast food restaurants both offer meals to customers.
• But a conventional restaurant has better service and you are paying more for the atmosphere although you may be getting the same quality food.
Advertising, Image, and Status:

- Firms often use advertising to point out differences between their own offerings and other products in the marketplace.
- These product differences are often more a matter of perception than reality.
- For example a designer can brand his name on a shirt that is no different than generic clothing but customers will get the shirt because of brand and status.
True Brand Name:

• In his days Judah shall be saved, and Israel shall dwell safely: and this is his name whereby he shall be called, THE LORD OUR RIGHTEOUSNESS. Jeremiah 23:6.
Brand Name Of the Church:

- Seventh-day (Sabbath) Adventist (Belief in the Second Coming).
What type of branding distinguishes Seventh-day Adventists?

• “But ye are a chosen generation, a royal priesthood, an holy nation, a peculiar people; that ye should shew forth the praises of him who hath called you out of darkness into his marvellous light:” 1 Peter 2:9.
What type of branding distinguishes Seventh-day Adventists?

• If ye love me, keep my commandments. John 14:15.
• “Here is the patience of the saints: here are they that keep the commandments of God, and the faith of Jesus.” Revelation 14:12.
• For the grace of God that bringeth salvation hath appeared to all men, Teaching us that, denying ungodliness and worldly lusts, we should live soberly, righteously, and godly, in this present world; Titus 2:11-12.
What type of branding distinguishes Seventh-day Adventists?

- (3Jn 1:2) Beloved, I wish above all things that thou mayest prosper and be in health, even as thy soul prospereth.
Prices, Output, and Profits.

• Prices under monopolistic competition will be higher than they would be in perfect competition, because firms have some power to raise prices.

• However the number of firms and ease of entry prevent companies from raising prices as high as they would if they were a true monopoly.
Prices, Output, and Profits.

• If a monopolistically competitive firm raised prices too high, most customers would buy the cheaper product.

• Because customers can choose among many substitutes, monopolistically competitive firms face more elastic demand curves than true monopolists do.
Output

• The law of demand says that output and prices are negatively related.
• As one rises, the other falls.
• Monopolistically competitive firms sell their products at higher prices than do perfectly competitive firms, but at lower prices than a monopoly.
• As a result, total output under monopolistic competition falls somewhere between that of monopoly and that of perfect competition.
Profits:

• Like perfectly competitive firms, monopolistically competitive firms earn just enough to cover all of their costs, including salaries for the workers.

• If a monopolistically competitive firm started to earn profits well above its costs, two market trends would work to take those profits away.
Profits:

• First, fierce competition would encourage rivals to find new ways to differentiate their products and lure customers back.
• The rivalries among firms prevent any one firm from earning excessive profits for long.
• For example: hiring celebrities of different fields to differentiate their products.
Profits:

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Profits:

• Second, new firms will enter the market with slightly different products that cost less than the market leaders.
• If the original good costs too much, consumers will switch to these substitutes.
• You’ve seen this happen when a brand-name line of clothing or a video game becomes popular.
• Competitors are quick to flood the market with cheap imitations (Transformers/Go Bots)
Profits:

• Although monopolistically competitive firms can earn profits in the short run, they have to work hard to keep their product distinct to stay ahead of their rivals.

• Often they don’t succeed.
Production Costs and Variety:

• Firms in monopolistic competition may not be able to produce their goods at the lowest possible average cost.

• Monopolistically competitive markets have many firms, each producing too little output to minimize costs and use resources efficiently.

• But consumers in these markets benefit from having a wide variety of goods to choose from.
Oligopoly:

- Describes a market dominated by a few large profitable firms.
- It looks like an imperfect form of monopoly.
- Economists usually call an industry an oligopoly if the four largest firms produce at least 70 to 80 percent of the output.
- Acting on their own for as a team, the biggest firms in an oligopoly may well set prices higher and output lower than in a perfectly competitive market.
- Examples are the air travel, automobile companies.
Barriers to Entry:

• An oligopoly can form the significant barriers to entry keep new companies from entering the market to compete with existing firms.

• These barriers can be technological or they can be created by a system of government licenses or patents.
Barriers to Entry:

• In some cases, economic realities of the market lead to oligopoly.
• Pepsi and Coke have developed their names and networks for so long few companies think they can successfully challenge.
• High Start up costs such as expensive machinery prevents small airlines to succeed.
• Also in a monopoly market, only one company can produce enough goods to earn a profit.
• In an oligopoly, perhaps three or four companies can reach a profitable level of output before the market becomes too crowded and revenues fall below costs.
Cooperation and Collusion:

- There are times when companies illegally work together to set prices and bar competing firms to enter the market.
- Sometimes the market leader is an oligopoly can start a round of price increases or price cuts by making its plans clear to other sellers.
Cooperation and Collusion:

• This firm becomes a price leader.
• Price leaders can set prices and output for entire industries as long as other member firms go along with the leader’s price policy.
• But disagreements among those companies can spark a price war when competitors cut their prices very low to win business.
• A price war is harmful to producers but goods for consumers because they will pay less for a good or service.
Cooperation and Collusion:

- Collusion refers to an agreement among members of an oligopoly to illegally set prices and production levels.
- One outcome of collusion is called price fixing, an agreement among firms to sell at the same or very similar prices.
- Collusive agreements set prices and output at the levels that would be chosen by a monopolist.
- Such pricing may actually result from intense competition especially in advertising, is vigorous and new lines of products are being introduced.
Cartels:

• Stronger than a collusive agreement, a cartel is an agreement by a formal organization of procedures to coordinate prices and production.

• Although other countries and international organizations permit them, cartels are illegal in the U.S. OPEC is the most famous.

• Cartels can survive only if every member keeps to its agreed output levels and non more.
Cartels:

- Otherwise, prices will fall, and firms will lose profits.
- However, each member has a strong incentive to cheat and produce more than its quota.
- If every cartel member cheats, too much product reaches the market, and prices fall.
- Cartels can also collapse if some producers are left out of the group and decide to lower their prices below the cartel’s levels.