Chapter 12 – Monopolistic Competition: The competitive model in a more realistic setting
Introduction - Starbucks

- 1971 – First Starbucks opens in ______
- 1981 –
- 1993 –
- 1996 –
- 2007 –
- worldwide
- 44 million customers each week!

Starbucks is ______ from the case of perfect competition, Why?
The Four Types of Market Structure

Number of Firms?

- Many firms
- Few firms
- One firm

Type of Products?

- Differentiated products
- Identical products

Monopoly
- Tap water
- Cable TV

Oligopoly
- Tennis balls
- Computer Chips

Monopolistic Competition
- Novels
- Movies

Perfect Competition
- Wheat
- Milk
Assumptions of Monopolistic Competition

1. Many Buyers and Sellers
2. Products are differentiated
3. No barriers to Entry
4. Perfect Information
   • Note: Assumption of identical products
   _______________
   • Step Towards reality
What is different about this demand curve compared to Perf. Comp.?

If this firm wants to sell more, what does it have to do?

On which units?

Result: The additional revenue of a Mon. Comp. firm is less than the price

MR Curve is Below the demand Curve
Marginal Revenue is Below Demand Curve when demand is downward sloping
Good and Bad of A Price Cut

• Good
  ◦ **Output effect:** Lower price means you sell ________________

• Bad
  ◦ **Price effect:** Lower price means your ________________ is lower.
Marginal Revenue for firm with Downward sloping demand curve

- Notice that Price does not equal MR
- Why?
- We see this through the change in total revenue
- Finally notice that average revenue always equals price

<table>
<thead>
<tr>
<th>CAFFÈ LATTES SOLD PER WEEK (Q)</th>
<th>PRICE (P)</th>
<th>MARGINAL REVENUE (( MR = \Delta TR/\Delta Q ))</th>
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Marginal Revenue is Below Demand Curve when demand is downward sloping
Example of Monopolistic Competition

- Let’s consider the iPhone
- What is going on with iPhone apps right now?
- What kind of market structure is this from the perspective of the apps builder?

- **Apps**
- **NYT**
Show Profits in the Price Quantity Graph

- **Step 1:** Go to the best point. Quantity where \( MR = MC \)
  - Find price from demand curve

- **Step 2:** Find Total Revenue
  - Total revenue = Price \( \times Q \) or \( (AR \times Q) \)

- **Step 3:** Find total costs
  - Total cost = Average Cost \( \times Q \)

The difference is Profit
Profits and Entry for Mon. Comp. Firm

- What happens when a monopolistic firm is seen to be making profits?
  - 
- Is the Product going to be Exactly Similar?
  - 
- What happens to the demand curve when there are more substitutes?
  - 
- Result: Mon. Comp firm making profits will face competition from _______ making its demand curve more elastic
Profits and Entry for Mon. Comp. Firm

- Is this firm making a profit or loss? How do you tell?
- What do you expect to happen?

Where is the new best spot when firms enter?

At the new best spot are there any profits?
Perfect Comp. Vs Monopolistic Comp.

- Perfect Comp. is the ‘standard’ so let’s do some comparison

- What are some thing we noticed that were different about Monopolistic Competition?

- In equilibrium:
  - In perfect comp. equilibrium was at the minimum of ATC. Is this true in monopolistic comp?
  - In perfect competition, equilibrium was where price = Marginal Cost. Is the consumer charged the MC in Monopolistic Competition?
  - Let’s see it
For Monopolistic Competition:
- Consumers have more additional benefit than the additional cost of production \(\rightarrow\) Not allocatively efficient
- Mon Comp. Firms may not produce at the lowest possible cost (not productively efficient), but society gets VARIETY in return.
Lessons for you as future workers

• What can you learn from Mon. Competition?

• L’OREAL responds to change well does this well

• Abercrombie & Fitch probably differentiated themselves too much

• Did you know?